90-505
No.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1990

CALIFORNIA PUBLIC UTILITIES COMMISSION,
Petitioner,

VS.

FEDERAL ENERGY REGULATORY COMMISSION
and
BONNEVILLE POWER ADMINISTRATION,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

1. Did the Ninth Circuit commit reversible error in failing to defer to the interpretation of the Federal Energy Regulatory Commission ("FERC") that Section 7(k) of the Pacific Northwest Electric Power Planning and Conservation Act ("Pacific Northwest Act"), 16 U.S.C. § 839e(k), authorizes it to hold an evidentiary hearing in reviewing rates charged customers in California by the Bonneville Power Administration ("BPA") for nonfirm energy?

2. Did the Ninth Circuit commit reversible error in failing to conduct a careful and searching review of the FERC's determination that customers in California should be assigned the BPA's fully-allocated costs on an unweighted, proportional basis in the rates they pay for nonfirm energy?

PARTIES TO THE PROCEEDING BELOW

The parties to the proceeding below were the following:

Petitioners

Aluminum Company of America
Arco Metals Company
California Energy Commission
California Public Utilities Commission
Los Angeles Department of Water and Power
Pacific Gas and Electric Company
San Diego Gas & Electric Company
Southern California Edison Company

Petitioner—Intervenor

Association of Public Agency Customers

Respondents

Bonneville Power Administration
Federal Energy Regulatory Commission

Respondent—Intervenors

Portland General Electric Company
Puget Sound Power & Light Company
Public Generating Pool

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The California Public Utilities Commission hereby petitions that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 891 F.2d 748 and, as amended, reproduced in Appendix A hereto. The Court of Appeal's order denying rehearing is reproduced in Appendix B. Opinion Nos. 250 and 250-A of the FERC are reported at 36 FERC ¶ 61,335 and 39 FERC ¶ 61,033, respectively, and reproduced in Appendices C and D.

JURISDICTION

The Court of Appeals entered its opinion and judgment on December 11, 1989, and amended that opinion on May 14, 1990. It denied timely petitions for rehearing on June 21, 1990. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 7(k) of the Pacific Northwest Act, 16 U.S.C. § 839e(k), states in full:

> Notwithstanding any other provision of this chapter, all rates or rate schedules for the sale of nonfirm electric power within the United States, but outside the region, shall be established after December 5, 1980, by the Administrator in accordance with the procedures of subsection (i) of this section (other than the first sentence of paragraph (6) thereof) and in accordance with the Bonneville Project Act [16 U.S.C.A. § 832 et seq.], the Flood Control Act of 1944, and the Federal Columbia River Transmission System Act [16 U.S.C.A. § 838 et seq.]. Notwithstanding section 201(f) of the Federal Power Act, [[16 U.S.C.A. § 824f], such rates or rate schedules shall become effective after review by the Federal Energy Regulatory Commission for conformance with the requirements of such Acts and after approval thereof by the Commission. Such review shall be based on the record of proceedings established under subsection (i) of this section. The parties to such proceedings under subsection (i) shall be afforded an opportunity by the Commission for an additional hearing in accordance with the procedures established for ratemaking by the Commission pursuant to the Federal Power Act. [16 U.S.C.A. § 8383 et seq.].

Section 9(e)(2) of the Pacific Northwest Act, 16 U.S.C. 839f(e)(2), states in relevant part:

> The record upon review of such final actions [taken by the BPA] shall be limited by the administrative record compiled in accordance with this chapter. The scope of review of such actions without a hearing or after a hearing shall be governed by section 706 of Title 5, except that final determinations regarding rates under section 839e of this title shall be supported by substantial evidence in the rulemaking record required by section 839e(i) of this title considered as a whole.

STATEMENT OF THE CASE

1. Introduction

This proceeding is the first in a series of cases in which the BPA has unlawfully discriminated against California in favor of the Pacific Northwest in the rates it charges for electrical power. In its decision below, the Court of Appeals permitted—indeed, facilitated—this discrimination. First, it held that, notwithstanding the plain language of Section 7(k) of the Pacific Northwest Act, the FERC has no authority to conduct an evidentiary hearing when reviewing rates charged California by the BPA, thus impairing its ability to protect California against the BPA's regional bias. Second, it held that the BPA may recover from customers in California through the rates it charges them for nonfirm energy various costs they have not caused the BPA to incur, thereby subsidizing customers in the Pacific Northwest. Because it will form the basis for all future rates first established by the BPA and then reviewed by the FERC, this decision, if allowed to stand, poses enormous economic consequences for consumers throughout California and the Pacific Northwest.

2. Planning and Operation of the BPA's System

The BPA is an agency of the federal government created by the Bonneville Project Act, 16 U.S.C. §§ 832 et seq., for the purpose of marketing in the Pacific Northwest electrical power produced by various federally-owned dams on the Columbia River. *See Aluminum Co. of America v. Central Lincoln Peoples' Utility District*, 467 U.S. 380, 382 (1984). Over time, the BPA has obtained authority to acquire additional resources. *Central Lincoln Peoples' Utility District v. Johnson*, 735 F.2d 1101, 1107 (9th Cir. 1984). It is also now authorized, pursuant to the Pacific Northwest Consumer Power Preference Act ("Regional Preference Act), 16 U.S.C. §§ 837 *et seq.*, to sell outside the Pacific Northwest electrical energy which is surplus to the needs of its customers in that region. *Id.* at 1112. Such energy is commonly referred to as "nonfirm" to distinguish it from the "firm" energy which the BPA makes available on demand and without interruption to its regional customers. *See California Energy Commission v. Johnson*, 767 F.2d 631, 632 (9th Cir. 1985); *U.S. Department*

of Energy—Bonneville Power Administration, 43 FERC ¶ 61,032, 61,088 (1988).

Consistent with the restrictions imposed by the Regional Preference Act, the BPA neither plans nor, except under certain limited circumstances, operates its system to produce nonfirm energy for sale outside the Pacific Northwest. In the first place, resources are installed in the Pacific Northwest for the sole purpose of meeting the needs of firm customers in that region. *See Central Lincoln Peoples' Utility District v. Johnson, supra*, 735 F.2d at 1107. Likewise, the BPA and the various utilities in the Pacific Northwest coordinate the operation of their systems for the primary purpose of providing reliable service to those customers. *Aluminum Co. of America v. BPA*, 891 F.2d at 751 (App. at A-11). Toward this end, the BPA operates its system based on the assumption "that each year will be equivalent to the driest year in recorded history." *California Energy Commission v. Johnson, supra*, 767 F.2d at 632.

Viewed in this light, the production of nonfirm energy by the BPA for sale to California can be seen as but an incidental byproduct of its system. At no time will the BPA operate thermal resources or purchase electrical power in order to sell nonfirm energy to California. Rather, when it does become available, such energy is a consequence simply of the BPA's inability to predict supply and demand in the Pacific Northwest and that region's decision to plan conservatively. On such occasions, the BPA has reduced the operation of its system to the extent not needed to serve firm load in the Pacific Northwest, operating in addition only those facilities whose output would be wasted if not sold outside that region. In the main, these are hydroelectric powerplants.

3. Statutory Background

During the 1970s, studies undertaken by the BPA indicated that the demand for electrical power in the Pacific Northwest would soon exceed that region's supply. *Aluminum Co. of America v. Central Lincoln Peoples' Utility District, supra*, 467 U.S. at 385. In 1980, faced with "the prospect of unproductive and endless litigation" over the allocation of such supply, Con-

gress enacted Public Law 96-501, the Pacific Northwest Act. *Id.* at 385-386. It intended by this action to achieve a workable compromise among the BPA and its customers regarding the BPA's production, acquisition, and sale of electrical power.

As a key element of this compromise, in order to protect California against the BPA's regional bias, Congress provided special direction to the BPA regarding rates to be charged for the sale of nonfirm energy within the United States but outside the Pacific Northwest. *Central Lincoln Peoples' Utility District v. Johnson, supra*, 735 F.2d at 1113. Under Section 7(k), the BPA is directed to establish such rates in accordance with the Bonneville Project Act, the Flood Control Act of 1944 (16 U.S.C. § 825s), and the Federal Columbia River Transmission System Act (16 U.S.C. §§ 838 et seq.). 16 U.S.C. § 839e(k). As summarized by the FERC, these statutes require that those rates be drawn:

1. having regard to the recovery of the cost of generation and transmission of such electric energy;

2. so as to encourage the most widespread use of Bonneville power;

3. to provide the lowest possible rates to consumers consistent with sound business principles; and

4. in a manner which protects the interests of the United States in amortizing its investments in the projects within a reasonable period.

See, e.g., 36 FERC at p.61,798. (App. at C-3 to C-4).

Section 7(k) also imposes significant responsibilities on the FERC regarding its review of rates charged California by the BPA. As part of that review, the FERC must determine whether such rates conform to the applicable statutory requirements. 16 U.S.C. § 839e(k). It is further directed, in making that determination, to conduct an additional hearing. *Id.* Moreover, at any such hearing, the BPA's rates are to be reviewed according to the procedures governing rates filed by public utilities under the Federal Power Act, 16 U.S.C. §§ 791a *et seq. Id.* In particular, these procedures expressly require the FERC to hold an eviden-

tiary hearing whenever "necessary to assure true and full complete disclosure of the facts." 18 C.F.R. § 385.505.

For its part, in reviewing rates established by the BPA and approved by the FERC for the sale of nonfirm energy to California, the Ninth Circuit shall apply three separate tests. First, it must determine whether the rates were established in accordance with the statutes enumerated in Section 7(k). 16 U.S.C. 839e(k). Second, it must determine whether the FERC's approval was arbitrary, capricious, or an abuse of discretion. 5 U.S.C. § 706(2)(A), as made applicable by 16 U.S.C. § 839f(e)(2). Third, it must determine whether such approval was "supported by substantial evidence in the ... record ... considered as a whole." 16 U.S.C. § 839f(e)(2). In making these determinations, the Ninth Circuit shall defer to the interpretation of any applicable statute by the agency charged with its administration. *Southern California Edison Co. v. FERC*, 770 F.2d 779, 782 (9th Cir. 1985). It must reject any such interpretation, however, which is inconsistent with the statutory mandate or would frustrate the policy Congress sought to implement. *Id.*

4. Procedural History

At issue in the present proceeding are two schedules of rates established by the BPA for the sale of nonfirm energy from July 1, 1981, through October 31, 1983: Schedules NF-1 and NF-2. On April 28, 1983, the FERC consolidated its review of these rates in a single proceeding and set them for hearing. *U.S. Department of Energy—Bonneville Power Administration*, 23 FERC ¶ 61,161. As explained by the FERC,

> [W]e find that significant questions have been raised by the parties regarding whether these schedules meet the standards set forth in the applicable power marketing statutes. Based on the record presented, we cannot make a determination as to whether the revenue proposed to be collected or the basis upon which the rate schedules have been designed is appropriate. We shall therefore set these matters for hearing.

Id. at p.61,354, *quoted in Aluminum Co. of America v. BPA, supra*, 891 F.2d at 755-756 (App. at A-21).

On September 24, 1986, the FERC issued Opinion No. 250, approving Schedules NF-1 and NF-2 on a final basis. As a starting point in its review of these rates, the FERC concluded that the BPA's system "is operated to maximize the production of useful energy." 36 FERC at pp.61,800-61,801 (App. at C-7). In the FERC's further opinion, because the BPA may operate thermal resources to insure the availability of sufficient water to meet its future needs, the BPA's incremental cost of energy is impossible to identify. *Id.* at p.61,801 (App. at C-8 to C-9). Thus, by the FERC's reasoning, the BPA may include on an unweighted, proportional basis in rates charged customers in California the fully-allocated costs of its resources—including the costs of the Washington Public Power Supply System ("WPPSS"), a series of nuclear powerplants whose construction was begun but not completed before the expiration of Schedules NF-1 and NF-2—whether or not those resources were installed or acquired to provide service to those customers, or even if they have less than equal access to the energy the BPA produces. *Id.* at pp.61,804-61,806 (App. at C-13 to C-17). On April 21, 1987, the FERC issued Opinion 250-A, denying petitions for rehearing of Opinion No. 250.

On December 11, 1989, the Ninth Circuit issued an opinion affirming Opinion No. 250. Early in that opinion, however, the court concluded that, despite the express language of Section 7(k), the FERC is without authority to hold an evidentiary hearing because its review must be based on the record developed by the BPA. 891 F.2d at 754-757 (App. at A-17 to A-23). Nonetheless, it agreed with the FERC that Schedules NF-1 and NF-2 properly included the full costs incurred by the BPA in producing and transmitting electrical power, including those relating to the WPPSS. *Id.* at 757-760 (App. at A-24 to A-30). On June 21, 1990, the Ninth Circuit denied petitions for rehearing of this decision.

REASONS FOR GRANTING THE WRIT

This case represents a matter of enormous magnitude for both California and the Pacific Northwest. Most immediately, if the decision below is allowed to stand, and appropriate refunds are

not ordered, consumers throughout California will have had to pay over a hundred million dollars in excess of the costs the BPA incurred in order to provide them service. Over the longer term, as the discriminatory practices of the BPA cease to make it any longer an economic, reliable source of supply, and California is forced to increase the development of its indigenous resources, the interregional market will suffer a severe and lasting decline.

Such a result would be particularly egregious in view of the restricted nature of the service California receives from the BPA. The refusal of the FERC to consider substantial evidence regarding the ramifications of this fact, together with its failure to apply in any meaningful way the statutory criteria governing ratemaking by the BPA, as well as its departure without reasoned explanation from well-established precedent, must be redressed. Indeed, in deciding that the BPA may include on an unweighted, proportional basis the full-allocated costs of its resources in rates charged California for nonfirm energy, the FERC rendered illusory the protection that Congress intended be provided against the BPA's regional bias.

The Ninth Circuit's opinion seriously compounds these errors. First, it too readily allows the FERC to depart from relevant precedent, to ignore substantial evidence regarding the manner in which the BPA plans and operates its system, and to misapply statutory criteria. Moreover, despite the express language of Section 7(k) of the Pacific Northwest Act, it deprives California of the right to an impartial hearing. For all of these reasons, review by this Court represents the final opportunity to reverse a result as unjust as it would be fiscally improvident.

I

THE NINTH CIRCUIT COMMITTED A CLEAR ERROR OF JUDGMENT IN FAILING TO GIVE PROPER DEFERENCE TO THE INTERPRETATION OF THE FERC THAT SECTION 7(k) OF THE PACIFIC NORTHWEST ACT AUTHORIZES IT TO HOLD AN EVIDENTIARY HEARING WHEN REVIEWING RATES THE BPA CHARGES CALIFORNIA FOR NONFIRM ENERGY.

Section 7(k) provides that, in reviewing rates the BPA charges California, the FERC shall conduct an additional hearing "in accordance with the procedures established for ratemaking by the [FERC] pursuant to the Federal Power Act." 16 U.S.C. § 839e(k). In the opinion below, the Ninth Circuit recognized that "a literal reading" of this provision "appears to allow an evidentiary hearing before FERC, because the additional hearing section 7(k) provides for under the Federal Power Act is a de novo proceeding in which the FERC takes evidence." 891 F.2d at 755, citing *Southern California Edison Co. v. FERC, supra*, 770 F.2d at 784, n.3. That should have ended its inquiry. As this Court has explained:

> If the statute is clear and unambiguous "that is the end of the matter, for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."

Board of Governors, FRS v. Dimension Financial, Corp., 474 U.S. 361, 386 (1986), *quoting Chevron U.S.A., Inc., v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-843 (1984). Furthermore, in interpreting a federal statute, the court should assume that congressional intent is accurately expressed by the ordinary meaning of the language employed. *Mills Music, Inc. v. Snyder*, 469 U.S. 153, 164 (1985).

Even if it decides that the intent of Congress is unclear or that the language of a statute is ambiguous, the court may not freely substitute its interpretation for that of the agency:

> If . . . the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would

> be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., supra, 467 U.S. at 843. In this event, the court may reject the agency's interpretation only if it is "arbitrary, capricious, or manifestly contrary to the statute." *Id.* at 844. *See also K Mart Corp. v. Cartier, Inc., supra*, 486 U.S. 281, 292 (1988) ("If the agency regulation is not in conflict with the plain meaning of the statute, a reviewing court must give deference to the agency's interpretation of the statute."). Here, however, rather than determining the FERC's interpretation to be any of these things, the Ninth Circuit found that "the question is close and very difficult." 891 F.2d 756 (App. at A-22). That, too, should have been the end of the matter.

Nonetheless, despite these admonitions, the Ninth Circuit fashioned its own construction of Section 7(k), rejecting the interpretation of the FERC that it is authorized to hold an evidentiary hearing in reviewing rates charged California by the BPA. In doing so, the court cited four reasons against such authority. None of these demonstrates, however, that the FERC's interpretation was in any way impermissible.

The court first observed that the FERC's review is limited by the requirement of Section 7(k) that it "be based on the record of proceedings established under subsection (i) of this section." 891 F.2d at 754 (App. at A-18 to A-19). Certainly, the FERC is required to take into account the record developed by the BPA in establishing those rates, but that is merely the starting point for its review. "Based on" does not, after all, mean "limited to." Requiring the FERC to base its review on that record simply specifies the foundation for its analysis. If the record developed by the BPA is inadequate, a further hearing before the FERC becomes necessary to resolve any matter in dispute as is the case in any proceeding involving ratemaking under the Federal Power Act. *See* 18 C.F.R. § 385.505. Indeed, this is precisely the purpose underlying the requirement of Section 7(k) that an opportunity

for an additional hearing "shall be afforded . . . in accordance with the procedures established for ratemaking by the [FERC] pursuant to the Federal Power Act." *See Southern California Edison Co. v. FERC, supra*, 770 F.2d at 784. As explained in the legislative history of Section 7(k), noted but misapplied in the opinion below, "FERC's review will be based on the BPA record *and on any FERC proceeding*." H.R. Rep. No. 96-976, Part 1, 96th Cong., 2d Sess. at 70 (emphasis added). *See* 891 F.2d at 760 (App. at A-23).

The second reason given by the court for rejecting the FERC's interpretation was that, because judicial review is limited by Section 9(e)(2) of the Pacific Northwest Act, 16 U.S.C. § 839(e)(2), to the record developed under Section 7(i), its consideration of another record would be "anomalous." 891 F.2d at 754-755 (App. at A-19). The court overlooked, however, that the record developed under Section 7(i) necessarily includes that developed under Section 7(k) as a consequence of the requirement of Section 7(i)(6) that, to become effective, rates established by the BPA must first be approved and confirmed by the FERC. Thus, while it may be a necessary condition, substantial evidence in the record developed by the BPA regarding rates charged California is not sufficient to withstand judicial review. Rather, the Ninth Circuit must also determine whether those rates are supported by the *whole record*, including that portion developed by the FERC.

The court's third reason was that, because the review conducted by the FERC pursuant to Section 7(k) is "appellate" in the sense that it may only approve or reject the rates in question and not impose new ones, a second evidentiary hearing would be "superfluous." *Id.* at 755 (App. at A-19 to A-21). To the contrary, however, an evidentiary hearing before the FERC would be far from superfluous. The intent of Congress to create an impartial forum depends entirely on the ability of the FERC to supplement the record developed by the BPA if it is found to be inadequate. Accordingly, even though the FERC cannot substitute rates of its own choosing, and its review may in this limited sense be considered "appellate," an additional evidentiary hearing is critically necessary in order to carry out congressional intent.

See Southern California Edison Co. v. FERC, supra, 770 F.2d at 784.

Finally, the court noted that Congress sought "to prevent protracted legal challenges to the BPA's ratemaking decisions." 891 F.2d at 756 (App. at A-20), citing *Central Lincoln Peoples' Utility District v. Johnson, supra*, 735 F.2d at 1114. Doubtlessly, as the Ninth Circuit pointed out in *Central Lincoln*, that was Congress's intent regarding regional rates. 735 F.2d at 1114. In distinct contrast, however, Congress intended to expand, not reduce, the FERC's responsibilities regarding rates charged California. *Id.* at 1113 ("The conscious effort to broaden review of nonregional rates is strong evidence that review of regional rates was to be narrow."). As the Ninth Circuit observed in *Central Lincoln*, concerning the need to protect interests outside the Pacific Northwest,

> [W]hile section 7(a)(2) directs FERC to confirm and approve regional rates upon making certain findings, section 7(k) expressly describes FERC's responsibilities to review nonregional rates for conformance with the broader rate-approval requirements of other applicable statutes.

Id. at 1112. With respect to rates charged California for nonfirm energy, therefore, multiple evidentiary hearings at different agencies was not only contemplated by Congress, but believed necessary to counteract the BPA's regional bias.

As a final matter, reference to a case in which this Court recently granted certiorari to review a decision of the Court of Appeals for the District of Columbia Circuit allocating jurisdiction between the FERC and the Securities and Exchange Commission underscores the importance of the matter at hand. *See Ohio Power Co. v. FERC*, 880 F.2d 1400, *cert. granted sub nom. Arcadia, Ohio v. Ohio Power Co.*, ____, U.S. ____; 108 L.Ed. 2d 762(1990). Regardless of the outcome of that case, one of the two agencies involved will provide an unbiased forum to address the petitioner's concerns. In the present proceeding, however, a far more serious situation is presented in which, depending on the outcome, the petitioner may be denied the opportunity for an impartial hearing. Either the BPA, with a well-recognized bias in

favor of the Pacific Northwest, will serve as the sole trier of factual issues regarding the rates it charges California or the FERC—directed by Congress to protect against such bias—will decide such matters.

II

IN FAILING TO CONDUCT A CAREFUL AND SEARCHING REVIEW OF THE FERC'S DETERMINATION THAT CUSTOMERS IN CALIFORNIA SHOULD BE ASSIGNED THE BPA'S FULLY-ALLOCATED COSTS ON AN UNWEIGHTED, PROPORTIONAL BASIS IN THE RATES THEY PAY FOR NONFIRM ENERGY, THE NINTH CIRCUIT COMMITTED REVERSIBLE ERROR.

In determining whether an agency's decision is arbitrary and capricious, the reviewing court must conduct a "searching and careful" inquiry. *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 416 (1971). The "cornerstone" of this inquiry is the requirement that the agency provide a reasoned explanation for its action. *CBS v. FCC*, 454 F.2d 1018, 1025 (D.C. Cir. 1971). In turn, this explanation must demonstrate "a rational connection between the facts found and the choice made." *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1968). As summarized by this Court,

> Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.

Motor Vehicle Manufacturers Association v. State Farm Mutual Insurance Co., 463 U.S. 29, 43 (1983).

With regard to rates established by the BPA for the sale of nonfirm energy to California, the Ninth Circuit must also determine whether the FERC's decision was supported by substantial evidence in the record considered as a whole. 16 U.S.C.

§ 839(e)(2). In making this determination, that court is required to assess carefully the evidence on both sides of each issue presented. As by this Court has explained,

> The substantiality of evidence must take into account whatever in the record fairly detracts from its weight. This is clearly the significance of the requirement . . . that courts consider the whole record.

Universal Camera Corp. v. NLRB, 340 U.S. 474, 488 (1951).

Adopting the FERC's findings and conclusions as its own, the Ninth Circuit agreed that customers in California should be assigned the BPA's fully-allocated costs on an unweighted, proportional basis. In doing so, however, it accepted a fundamental fallacy of Opinion No. 250 that the BPA's system is operated to maximize the production of useful energy. *See* 891 F.2d at 757 (App. at A-24). The BPA will certainly operate any resource at its disposal—and in some years even purchase electrical power—necessary to meet the needs of firm customers in the Pacific Northwest, but at no time will it take such steps to insure the availability of nonfirm energy for California. Indeed, it is prohibited from jeopardizing service to the Pacific Northwest in this way both through contractual agreement and by operation of law. *See Central Lincoln Peoples' Utility District v. Johnson*, 735 F.2d at 1112. Moreover, the record developed in this proceeding conclusively demonstrates that resources are installed in the Pacific Northwest for the sole purpose of meeting firm load in that region. (Evidence to the contrary which is cited by the Ninth Circuit in its opinion, 891 F.2d at 759 (App. at A-28), can best be described as negligible and self-serving on the part of the BPA. *See* Administrator's 1982 Record of Decision at 118.) For example, as stated by the BPA, "sales of [nonfirm] energy do not influence the choice, type, size, or location of the next increment of generation on the system." Exhibit 8H from the FERC's hearing at p.VIII-73.

A further, related fallacy of Opinion No. 250, also accepted without question by the Ninth Circuit, is that the BPA cannot determine its incremental cost at any particular time. *See* 891 F.2d at 757 (App. at A-24 to A-25). In truth, the BPA is no less

able to make that determination than is any utility. While the BPA may be said to "store" thermal resources in its reservoirs in order to conserve hydro resources for future use, utilities throughout the nation operate hydro resources or purchase power so as to avoid having to use their more expensive thermal resources. *See* 36 FERC at p.61,801 (App. at C-8). In either case, the purpose is the same: to achieve the least-costly mix of resources to serve firm customers.

Also beside the point is the notion that customers in California benefit from the BPA's entire system. *See* 891 F.2d at 757 (App. at A-25). In Opinion No. 250, the FERC observed that its "decisions under the Federal Power Act may serve as useful guides in addressing the question of how properly to develop costs for [the BPA's] nonfirm energy rate determination." 36 FERC at p.61,820, n.12 (App. at C-40). Indeed they may, but none of those cited in Opinion No. 250 supports the assignment of the BPA's fully allocated costs to California on an unweighted, proportional basis. *See id.* at p.61,802. Rather, in each of those decisions, the FERC allowed the selling utility to recover at most only some portion of its fully-allocated costs from the sale of nonfirm energy. *See Minnesota Power & Light Co.*, 11 FERC ¶ 61,312, 61,648 (1980); *Boston Electric Co.*, 53 F.P.C. 1545, 1563 (1975); *Delmarva Power & Light Co.*, 25 F.E.R.C. ¶ 61,308, 61,696 (1983), *vacated and remanded on other grounds, City of Newark v. FERC*, 770 F.2d 1131 (D.C. Cir. 1985); *Wisconsin Public Service Corp.*, 25 FERC ¶ 61,101, 61,325 (1983).

Similarly misleading is the FERC's reference in Opinion No. 250 to the case of *Illinois Power Co.*, 11 FERC ¶ 61,186 (1980), in support of the proposition that "[i]t is equitable for purchasers benefitting from capacity to make contributions toward the cost of that capacity." 36 FERC at p.61,802 (App. at C-11); *see also* 891 F.2d at 757 (App. at A-25). In the first place, the rates at issue in that case were for service that could be "reserved" by the purchases for a period of up to an entire year (*see* 5 FERC ¶ 63,071 at pp.65,106-65,107 (1978)), and was therefore much more like the firm service provided the Pacific Northwest than the nonfirm service provided California in the present proceeding ("the reservation carries an obligation to serve quite as complete

and binding as the company's obligation to its [firm customers]," 5 FERC at p.65,107.) Moreover, even for that service, the FERC would not allow 100 percent of the cost of capacity to be included in rates:

> [F]or reasons of equity, we believe that some capacity cost contribution, which is *significantly less than full allocated capacity costs*, by customers for this [nonfirm] service is supportable.

11 FERC at p.61,384 (emphasis added).

The FERC's sense of equity is particularly questionable in that all relevant considerations lead to the conclusion that the assignment to customers in California of the BPA's fully-allocated costs on an unweighted, proportional basis would prove highly unfair. Not only do those customers have no claim on the BPA's capacity, but they must stand in line behind all other customers to receive service from the BPA. And even when it is offered for sale to California, nonfirm energy is at all times subject to interruption if later needed in the Pacific Northwest. Moreover, in a prior case involving the BPA, the FERC recognized that, as a "lesser quality product," nonfirm energy should be sold to California at a lower price than the "higher quality firm power sold within the region." *U. S. Department of Energy, Bonneville Power Administration*, 23 FERC ¶ 61,342 at pp.61,739-61,740 (1983) (before passage of the Pacific Northwest Act, but applying the statutes enumerated in Section 7(k)). Indeed, the failure of the FERC to explain why it departed from that precedent, as well as the other cases cited in Opinion No. 250, in approving Schedules NF-1 and NF-2 constitutes in itself ground for reversal. *Motor Vehicle Manufacturers Association v. State Farm Mutual Insurance Co.*, *supra*, 463 U.S. at 41-42; *Atchison, Topeka & Santa Fe Railway Co. v. Wichita Board of Trade*, 412 U.S. 800, 807-808 (1973).

The FERC further ignored its responsibilities by failing to determine whether Schedules NF-1 and NF-2 satisfied the criteria of Section 7(k)—in particular, the requirement that those schedules serve to encourage the most widespread use of nonfirm energy at the lowest possible price to California. As the Ninth Circuit explained in *Central Lincoln*, *supra*, 735 F.2d at 1113-1115, this

requirement obligates the FERC to review how the BPA allocates its costs and designs the rates to be charged California. Indeed, to ignore the purpose for which resources are installed in the Pacific Northwest, and thus who actually caused their costs to be incurred, would be to render meaningless the special protection Congress intended in enacting Section 7(k). *See id.* at 1113. Having neither considered these factors nor rationally exercised its discretion, the FERC committed a clear error of judgment which should have been reversed. *Motor Vehicle Manufacturers Association v. State Farm Mutual Insurance Co., supra,* 463 U.S. at 43; *Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281 (1974).

Nor can the BPA's design of Schedules NF-1 and NF-2 be reconciled with sound business principles. Thus, the amount of energy which the BPA has available for sale to California can vary greatly from year to year, depending on conditions of supply and demand in Pacific Northwest: if streamflows are large or demand is low in that region, more will be available; conversely, if streamflows are low or demand there is high, less will be. Necessarily, therefore, if rates charged customers in California are designed to recover substantially more than the cost it actually incurs in order to provide them service, the BPA will face the strong prospect of underrecovering its total costs. By contrast, if rates charged customers in the Pacific Northwest are designed to recover the full cost of providing them service, no such problem need arise—whatever may be supply and demand in that region.

For similar reasons, the inclusion of fully-allocated costs in rates charged California would not improve the BPA's ability to repay the United States Treasury. Under Section 7(a)(2) of the Pacific Northwest Act, 16 U.S.C. § 839(a)(2), the BPA is required to design rates to be charged for firm power in such a manner that they be sufficient to meet its financial obligations and recover its total costs. In practice, however, the BPA credits revenues it forecasts will be received from the sale of nonfirm energy against the costs it allocates to firm power. *See* 36 FERC at p.61,819, n.9 (App. at C-39). Thus, higher rates for nonfirm energy simply mean lower rates for firm power. Again, if rates charged customers in California are designed to recover more

than the cost of providing them service, and revenues collected from those customers prove less than forecast, the BPA may be unable to recover its total costs.

These conclusions apply with special force to the BPA's "ancillary costs" relating to the WPPSS. *See* 39 FERC at p.61,096 (App. at D-46). Not only was no power produced by these facilities during the time when Schedules NF-1 and NF-2 were in effect, but their construction, like that of any other powerplant in the Pacific Northwest, was undertaken solely to serve firm load in that region. Moreover as overlooked by both the FERC and the court below, failure to apportion the costs of the WPPSS to customers in California would neither preclude their allocation to other customers nor shift their recovery to federal taxpayers. *See* 39 FERC at p.61,096 (App. at D-46); 891 F.2d at 759 (App. at A-28). Rather, under Section 7(a)(2)(B) of the Pacific Northwest Act, 16 U.S.C. § 839e(a)(2)(B), costs not allocated to customers in California become the responsibility of the BPA's regional customers. *See Central Lincoln, supra*, 735 F.2d at 1115. In sum, the failure of the Ninth Circuit, like the FERC before it, to take these various factors into account, much less to apply them to the standards of Section 7(k)—indeed, to undertake a careful and searching review— necessitates reversal by this Court. *Universal Camera Corp. v. NLRB, supra*, 340 U.S. at 491.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari to the Ninth Circuit should be granted.

Respectfully submitted,

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September 19, 1990

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Appendix A

FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

ALUMINUM COMPANY OF AMERICA; ARCO METALS COMPANY; COLUMBIA FALLS ALUMINUM COMPANY, *Petitioners,* ASSOCIATION OF PUBLIC AGENCY CUSTOMERS, *Petitioner-Intervenor,* v. BONNEVILLE POWER ADMINISTRATION; FEDERAL ENERGY REGULATORY COMMISSION; *Respondents,* PORTLAND GENERAL ELECTRIC COMPANY; PUGET SOUND POWER & LIGHT COMPANY; PUBLIC GENERATING POOL (PGP), *Respondents-Intervenors.*	No. 87-7303 BPA Nos. EF-81-2011-003 EF-82-2011-003
CALIFORNIA ENERGY COMMISSION, *Petitioner,* v. BONNEVILLE POWER ADMINISTRATION; FEDERAL ENERGY REGULATORY COMMISSION, *Respondents.*	No. 87-7308 BPA Nos. NF-2 Rates NF-1 Rates

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA; SOUTHERN CALIFORNIA EDISON COMPANY; PACIFIC GAS AND ELECTRIC COMPANY; SAN DIEGO GAS & ELECTRIC COMPANY; DEPARTMENT OF WATER AND POWER OF THE CITY OF LOS ANGELES, et al.,
Petitioners,

v.

BONNEVILLE POWER ADMINISTRATION; FEDERAL ENERGY REGULATORY COMMISSION,
Respondents.

No. 87-7313

BPA Nos.
EF-82-2011-003
EF-81-2011-003

ORDER AND AMENDED OPINION

Petition to Review a Decision of the Federal Energy Regulatory Commission

Argued and Submitted March 9, 1989
Portland, Oregon

Filed December 11, 1989
Amended May 14, 1990

Before: William C. Canby, Jr., David R. Thompson and Edward Leavy, Circuit Judges.

Opinion by Judge Leavy

SUMMARY

Administrative Law

Affirming the Federal Energy Regulatory Commission's decision to approve the rates the Bonneville Power Adminis-

tration established for nonfirm energy, the court held that the FERC evidentiary hearing held upon review of the rates violated § 7(k) of the Pacific Northwest Power Planning and Conservation Act, 16 U.S.C §§ 839e(k) (1982).

The court amended its opinion filed December 11, 1989.

These consolidated cases challenge the first nonfirm energy rates that the BPA established and the FERC approved under section 7(k) of the Regional Act. Nonfirm power is energy in excess of firm power, and is provided only when such excess exists. The NF-1 and NF-2 rates applied to sales of nonfirm energy both in and outside the Pacific Northwest. BPA's direct service industrial customers and others alleged that BPA's rates were too low. The California Energy Commission and others alleged that BPA's nonfirm energy rates were too high. After lengthy evidentiary hearings, BPA proposed the NF-1 and 2 electric rates. In April of 1983, FERC consolidated its review of the nonfirm rates and set them for an evidentiary hearing before an administrative law judge who disapproved the rates as not conforming to section 7(k) of the Regional Act. All parties to the consolidated case were represented at the FERC hearing. The parties filed exceptions to the ruling and the full Commission then reviewed the rates. Except as modified or reversed, the Commission affirmed the ALJ's decision. The Commission modifications included elimination of a cap on the amount of thermal capacity costs, no approval of the inclusion of costs of the residential exchange program in the rates, and FERC found BPA's failure to design nonfirm rates to recover its costs was not a basis for rejection of the rates. The parties petitioned for review of FERC's decision.

[1] BPA claimed that the California utilities do not have standing because they failed to allege an injury. However, the California utilities do allege an injury: excessive rates due to costs that should not have been included in the NF-1 and 2

rate schedules. The relief sought would cure their injury. They have standing.

[2] In addition to the four requirements that BPA must meet with respect to nonfirm energy rates, [3] the California energy commission contended there is a fifth ratemaking standard. The CEC states that statutes embodied in section 7(k) require that BPA sell extraregional nonfirm energy on fair and reasonable conditions, citing 16 U.S.C. § 825s in support. [3] On reading section 825s, the court agreed with BPA that it does not refer to ratemaking per se, but rather to the overall requirement of fairness in the delivery of power by BPA.

[4] The Northwest parties contended that FERC violated section 7(k) by failing to base its NF-1 and 2 rates solely on the BPA administrative record. They claimed arguments were raised and evidence was presented at the hearing that were not before BPA when BPA decided the nonfirm rates. [5] FERC claimed that section 7(k) does not limit its review to the BPA record, but in the last sentence provides for an additional hearing which must be given effect. [6] Although the Regional Act is no model of clarity and the question was close and difficult, the court was persuaded that FERC should not have held the evidentiary hearing upon review of the nonfirm rates because FERC thought the BPA record was inadequate and wanted to supplement it. Congress designed the Act to prevent protracted legal challenges to BPA's ratemaking decisions. This objective is not served by multiple evidentiary hearings at different agencies. [7] This interpretation will also prevent parties from sitting out the BPA hearings as happened here in contravention of the Regional Act. [8] Since FERC's procedural error made its review overly broad, the court did not have to remand but could proceed instead to the merits.

[9] The main contention of the California parties was that BPA could not reasonably include its full capacity and energy

costs in the NF-1 and 2 rates and do so on an unweighted, proportional basis. [10] The California parties presented the same arguments on appeal that FERC has decided. In light of section 7(k)'s mandate that rates be set with regard to the recovery of the cost of generating and transmission of electric energy, FERC's approval of BPA's decision to charge full costs to nonregional customers was reasonable and amply supported by the record.

[11] As to whether the residential exchange program should be included in the nonfirm rates, the court found that the costs of the residential exchange program are not to be assessed against nonfirm energy customers, adopting the FERC's findings and conclusions on this issue.

[12] Without question, the NF-1 and 2 rates did not recover the cost to produce the nonfirm energy sold to California. However, the issue was whether the rates as designed, not the rates as collected were appropriate under the Act. [13] Although it was a difficult question, the NF-1 and 2 rates appear to conform to the statutory boundaries. BPA operates its system to maximize the production of useful energy. Not knowing exactly what future market conditions would be when it designed the rates, BPA properly allowed for below-cost rates in conditions where energy might otherwise be wasted. FERC's conclusion is reasonable that the widespread use requirement provides BPA with wide latitude in designing nonfirm energy rates.

COUNSEL

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Joanne Leveque, Washington, D.C., for the respondent.

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Frederic A. Morris, Perkins Coie, Seattle, Washington, for the respondent-intervenor.

Jay T. Waldron, Schwabe, Williamson, Wyatt, Moore & Roberts, Portland, Oregon, for the respondent-intervenor.

ORDER

Bonneville Power Administration's motion to amend opinion is granted.

The opinion filed in the above matter on December 11, 1989, appearing at 891 F.2d 748, is amended as follows:

1. slip op. at 14304:

replace: "This energy is referred to as "nonfirm" energy, to distinguish it from the "firm" energy that BPA is required to provide to its Pacific Northwest customers first, pursuant to the Pacific Northwest Consumer Power Preference Act of 1964 (the Regional Preference Act), 16 U.S.C. §§ 837-837h (1982). *Department of Water and Power of Los Angeles v. Bonneville Power Admin.*, 759 F.2d 684, 687 (9th Cir. 1985)." *with*: "BPA also markets power outside the Pacific Northwest, but only if it is surplus. 16 U.S.C. 837a (1982). All surplus power sales are subject to the Pacific Northwest Consumer Power Preference Act of 1964 (the Regional Preference Act), 16 U.S.C. §§ 837-837h (1982). This case involves rates for the sale of surplus nonfirm power. Nonfirm power is energy in excess of firm power, and is provided only when such excess exists. *Aluminum Co. of America v. Central Lincoln People's Util. Dist.*, 467 U.S. 380, 383 (1984)."

2. slip op. at 14318: insert the following paragraph, in which deletions are indicated by surrounding strike-outs and insertions are underlined: "FERC determined it was undisputed that BPA operates its system to maximize the production of useful energy, 36 F.E.R.C. ¶ 61,335 at 61,802, which more often than not results in the production of /s/u/r/p/l/u/s/ *nonfirm* energy that is sold to California. FERC decided that the incremental cost of /s/u/r/p/l/u/s/ *nonfirm* energy, which is what the California parties want the rate based upon, is impossible to determine because water in the reservoirs that produces nonfirm energy results not just from stream inflow, but from the use of thermal generating plants and conservation as well."

3. The identical sentences at slip op. 14299 and 14303 should be replaced as follows, in which deletions are indi-

cated by surrounding strike-outs and insertions are underlined: "Nonfirm *power is* energy /i/s /th/a/t/ /e/n/e/r/g/y/ /t/h/a/t /i/s/ /s/u/r/p/l/u/s/ /t/o/ /t/h/e/ /n/e/e/d/s/ /o/f/ /t/h/e/ /P/a/c/i/f/i/c/ /N/o/r/t/h/w/e/s/t/ in excess of firm power, and is provided only when such excess exists."

4. slip op. at 14323-324: replace the present paragraph as follows, in which the insertions have been underlined:

"FERC determined that Congress wanted the costs of this subsidy to be borne by the direct service industrial customers *prior to July 1, 1985*. It found that although the Act itself did not specify which customers should share in the cost of the program, legislative history stated Congress' preference: "the loss in revenue to the Administrator is in effect returned by the higher direct service industry rates." 36 F.E.R.C. ¶ 61,335, at 61,812 (quoting H.R. Rep. No. 96-976, pt. I, p. 29 (1980)). This court has also observed that "[t]he cost of this 'money-losing program' . . . is largely borne by BPA's direct-service industrial customers." *California Energy*, 807 F.2d at 1460 (citing 16 U.S.C. § 839(c)(1)). Therefore, we find that, *for rates in effect prior to July 1, 1985*, the costs of the residential exchange program are not to be assessed against nonfirm energy customers. We adopt FERC's findings and conclusions on this issue."

OPINION

LEAVY, Circuit Judge:

OVERVIEW

These consolidated cases challenge the first nonfirm energy rates that the Bonneville Power Administration (BPA) established, and the Federal Energy Regulatory Commission (FERC) approved, under section 7(k) of the Pacific North-

west Electric Power Planning and Conservation Act (the Regional Act), 16 U.S.C. § 839e(k) (1982).[1] Nonfirm power is energy in excess of firm power, and is provided only when such excess exists. The challenged rates, schedules NF-1 and NF-2, were effective from July 1, 1981, through September 30, 1982, and from October 1, 1982, through October 31, 1983, respectively. The NF-1 and NF-2 rates applied to sales of nonfirm energy both in and outside the Pacific Northwest.

In case No. 87-7303, BPA's direct service industrial customers, joined by intervenors the Public Generating Pool, Public Power Council, Association of Public Agency Customers, and Portland General Electric (the Northwest parties), allege that BPA's rates for electricity under NF-1 and NF-2 were too low. The Northwest parties claim the rates: (1) failed to recover the costs of nonfirm energy, (2) failed to include the costs of the residential exchange program, and (3) that FERC failed to review the rates based on the administrative record of BPA.

In cases Nos. 87-7308 and 87-7313, the California Energy Commission, the Public Utilities Commission of the State of California, and the California Utilities (Southern California Edison Company, Pacific Gas & Electric Company, San Diego Gas & Electric Company, and the Cities of Los Angeles, Burbank, Glendale, and Pasadena) allege that BPA's nonfirm energy rates under NF-1 and NF-2 were too high. These California parties claim that the rates should not have included an unweighted, proportionate share of the costs of BPA's generating capacity, the costs of the mothballed nuclear plants of the Washington Public Power Supply System (WPPSS), or the costs of conservation of fish, wildlife, and energy in the Pacific Northwest.

We hold that the evidentiary hearing that FERC held upon review of the rates violated section 7(k); nonetheless, we

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[1]The Regional Act in its entirety is found at 16 U.S.C. § 839-839h (1982).

affirm FERC's decision to approve the rates BPA established for nonfirm energy under schedules NF-1 and NF-2 from 1981 to 1983.

FACTS

BPA is a self-financing power marketing agency within the United States Department of Energy. The rates BPA receives for electricity and its transmission are BPA's only sources of revenue. *Central Lincoln Peoples' Util. Dist. v. Johnson*, 735 F.2d 1101, 1116 (9th Cir. 1984). Various federal acts require the BPA administrator periodically to revise rates to recover the capital costs and expenses associated with the Columbia River power system. 16 U.S.C. §§ 832f, 838g, 839e(a)(1) (1982). BPA is required to meet all interest and amortization payments owed to the United States Treasury for federal investments in BPA power and transmission systems. 16 U.S.C. §§ 839(4), 839e(a)(1).

BPA's combined generation and transmission facilities are known as the Federal Columbia River Power System. *See* 16 U.S.C. § 839a(10)(A). BPA also purchases energy from other utilities and accumulates it through conservation measures. Currently, BPA markets power generated at thirty federal hydroelectric projects and two nuclear plants, WPPSS Plant No. 2 and Trojan. The primary marketing area is the Pacific Northwest, comprised of the states of Washington, Oregon, and Idaho; Montana west of the Continental Divide; and the parts of Utah, Wyoming, and Nevada that are within the Columbia River drainage. 16 U.S.C. § 839a(14). BPA also markets power outside the Pacific Northwest, but only if it has the surplus energy to do so. 16 U.S.C. § 837a (1982). BPA also markets power outside the Pacific Northwest, but only if it is surplus. 16 U.S.C. 837a (1982). All surplus power sales are subject to the Pacific Northwest Consumer Power Preference Act of 1964 (the Regional Preference Act), 16 U.S.C. §§ 837-837h (1982). This case involves rates for the sale of surplus nonfirm power. Nonfirm power is energy in excess of

firm power, and is provided only when such excess exists. *Aluminum Co. of America v. Central Lincoln People's Util. Dist.*, 467 U.S. 380, 383 (1984).

BPA's energy system is planned around a hypothetical "critical water" supply, in which BPA measures its ability to meet the demand for power in the Pacific Northwest by assuming streamflows will be the worst on record and thermal generation and power purchases occur as planned. Nonfirm energy may result from streamflows in excess of critical, so long as reservoirs appear to be refilling on schedule. *See, e.g., Central Lincoln*, 735 F.2d at 1112. This planning method results in large amounts of nonfirm energy in most years. Consequently, BPA counts on nonfirm energy and makes decisions based on its availability.

BPA integrates hydroelectric energy production with other energy-producing resources. For example, when thermal resources are used to generate energy in the fall and early winter, the water that otherwise would have been used is stored behind the dams for later energy production. Therefore, BPA describes the reservoir as an "inventory" of energy, in which the quantity of water depends not only on streamflows, but on the use of thermal resources, power purchases, and conservation. Thus, electricity produced by dams may result from water whose energy content is attributable to the use of thermal or other resources, as well as to streamflow. According to BPA, it is impossible to attribute a unit of nonfirm energy to the resource that produced it, because the water supply is dependent on the use of several different resources. BPA operates the system not only to meet firm energy demands of the Pacific Northwest, but to maximize the amount of nonfirm energy produced.

While the NF-1 and 2 rates that BPA established were capped at cost, below-cost sales occurred to avoid wasting this surplus energy. According to BPA, California utilities saved $1.5 billion by buying electricity from BPA from July

1981 through October 1983, while at the same time BPA realized only $270 million in cumulative NF-1 and 2 revenues. BPA incurred revenue shortfalls in the years these rates were in effect, which resulted in missed interest and principal payments owed to the United States Treasury.

Prior Proceedings

After lengthy formal evidentiary hearings, BPA proposed the NF-1 and 2 electric rates. In April of 1983, FERC consolidated its review of the NF-1 and 2 rates and set them for an evidentiary hearing before an administrative law judge (ALJ). *United States Dept. of Energy—Bonneville Power Admin.*, 23 F.E.R.C. ¶ 61,161, 61,354 (1983). All parties to the consolidated case before this court were represented at the FERC hearing.

The ALJ disapproved the NF-1 and 2 rates as not conforming to section 7(k) of the Regional Act. He stated:

> The loser under the NF-1 and NF-2 rates has been BPA. The nonfirm customers were grossly undercharged for energy and this violated the fairness principle of cost allocations encompassed, in this case, within the "lowest possible rates to consumers consistent with sound business principles" requirement found in the statutory standards.... BPA came up short in revenue and could not pay on its federal debt and had its deferred interest payments increase.

29 F.E.R.C. ¶ 63,039, 65,122 (1984). The parties filed exceptions to this ruling; therefore, the full Commission reviewed the NF-1 and 2 rates. *See generally* 18 C.F.R. §§ 385.708(d), 385.711 (1984) (sets forth procedures for review of an initial decision by the Commission).

In Opinion No. 250, the full Commission modified and reversed the decision of the ALJ in part, and approved and

confirmed NF-1 and 2 rates precisely as BPA had originally filed them. *U.S. Dep't of Energy—Bonneville Power Admin.*, 36 F.E.R.C. ¶ 61,335 (1986). Rate determinations become final upon confirmation and approval by FERC. 16 U.S.C. § 839e(a)(2); *Central Lincoln*, 735 F.2d at 1105. In Opinion No. 250-A, the Commission denied a petition for a rehearing.

Except as modified or reversed, the Commission affirmed and adopted the ALJ's decision. The modifications of significance to this appeal are: (1) FERC eliminated a cap on the amount of thermal capacity costs included in the rates, 36 F.E.R.C. ¶ 61,335, at 61,808; (2) FERC did not approve the inclusion of costs of the residential exchange program in the rates, *id.* at 61,800, 61,811-813;[2] and (3) FERC found BPA's failure to design nonfirm rates to recover its costs was not a basis for rejection of the rates. *Id.* at 61,817-19.

The Northwest and California parties timely petitioned for review of FERC's decision.

STANDARD OF REVIEW

The Regional Act provides a specific standard of review for final determinations of electric rates. This court must affirm the rates if "substantial evidence in the rulemaking record" supports BPA's determination. 16 U.S.C. § 839f(e)(2); *Central Lincoln*, 735 F.2d at 1116. We must also affirm the agency's action unless it is arbitrary, capricious, an abuse of discretion, or in excess of statutory authority. 16 U.S.C. § 839f(e)(2); *California Energy Resources Conservation and*

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[2]The residential exchange program provides that any Northwest utility with high system costs may sell power to BPA at their average system cost, then purchase from BPA an equal quantity of low cost federal power. The benefits are to be passed on directly to the residential customers. *California Energy Resources Conservation and Dev. Comm'n v. Johnson*, 807 F.2d 1456, 1460 (9th Cir. 1986). The cost is borne by BPA's direct-service industrial customers. *Id.* (citing 16 U.S.C. § 839e(c)(1)).

Dev. Comm'n v. Bonneville Power Admin., 831 F.2d 1467, 1472 (9th Cir. 1987), *cert. denied*, 109 S. Ct. 58 (1988).

We defer to the interpretation of a statute by the agencies charged with administering it. *Southern Cal. Edison Co. v. FERC*, 770 F.2d 779, 782 (9th Cir. 1985). Because BPA drafted the Regional Act, its interpretation is to be given "great weight" and should be upheld if reasonable. *Aluminum Co. of America v. Central Lincoln Peoples' Util. Dist.*, 467 U.S. 380, 389-90 (1984); *California Energy Resources Conservation and Dev. Comm'n v. Johnson*, 807 F.2d 1456, 1459 (9th Cir. 1986). In a complex ratemaking case such as this, we also defer to FERC's substantial expertise in approving and confirming BPA's rates. *See Papago Tribal Util. Auth. v. FERC*, 773 F.2d 1056, 1058 (9th Cir. 1985) (deference given to FERC in ratemaking under the Federal Power Act, 16 U.S.C. §§ 824 et seq.), *cert. denied*, 475 U.S. 1108 (1986). However, the courts are the final authorities on issues of statutory construction. They must reject administrative constructions of a statute that are inconsistent with the statutory mandate or that frustrate the policy Congress sought to implement. *Southern Cal. Edison*, 770 F.2d at 782.

DISCUSSION

Whether the California Utilities Have Standing

BPA argues the California utilities do not have standing because they saved a windfall $1.5 billion by voluntarily purchasing BPA surplus energy. This contention is without merit. To have standing, a petitioner must show the challenged action caused them "injury in fact;" that the injury was within the "zone of interests" to be protected by the statutes that were allegedly violated, *Starbuck v. City and County of San Francisco*, 556 F.2d 450, 458 (9th Cir. 1977) (citing *Sierra Club v. Morton*, 405 U.S. 727, 733 (1972)), and that the relief sought would cure the injury. *Id.* at 458 (citing *Warth v.*

Seldin, 422 U.S. 490, 505 (1975); *Simon v. Eastern Kentucky Welfare Rights Org.*, 426 U.S. 26, 38 (1976)).

[1] While BPA agrees the California utilities' claims are within the "zone of interests" to be protected by section 7(k) of the Regional Act, it claims the utilities lack standing because they failed to allege any injury. However, the California utilities do allege an injury: excessive electricity rates due to costs that should not have been included in the NF-1 and 2 rate schedules. There is harm in paying rates that may be excessive, no matter what the California utilities may have saved. Further, if the utilities are correct, the relief sought would cure their injury: they will receive a refund of overpayments with interest. 18 C.F.R. § 300.20(c)(2) (1984). Therefore, the utilities have standing.

Whether There Is A "Fair and Reasonable" Standard for Ratemaking

Section 7(k) requires BPA to establish nonfirm energy rates sold outside the Pacific Northwest in accordance with the Bonneville Project Act, 16 U.S.C. §§ 832-832*l* (1982), the Flood Control Act of 1944, 16 U.S.C. § 825s (1982), and the Federal Columbia River Transmission System Act, 16 U.S.C. §§ 838-838k (1982). 16 U.S.C. § 839e(k). These three Acts require that BPA rates for nonfirm energy be drawn:

1. having regard to the recovery of the cost of generation and transmission of such electric energy;

2. so as to encourage the most widespread use of Bonneville power;

3. to provide the lowest possible rates to consumers consistent with sound business principles; and

4. in a manner that protects the interests of the United States in amortizing its investments in the projects within a reasonable period.

Central Lincoln, 735 F.2d at 1114; *see also* Opinion No. 250, 36 F.E.R.C. ¶ 61,335, at 61,798.

[2] The California Energy Commission (CEC) contends there is a fifth ratemaking standard. The CEC states: "statutes embodied in Section 7(k) require first that BPA sell extraregional nonfirm energy 'on fair and reasonable terms and conditions.' " The CEC cites for support the Flood Control Act, 16 U.S.C. § 825s, and Opinion No. 250, 36 F.E.R.C. ¶ 61,335, at 61,820 n.20. BPA, on the other hand, contends that the Flood Control Act does not refer to ratemaking in section 825s,[3] but reflects Congress' desire to limit federal transmission capacity only to the extent that sales of federal power can be economic. BPA claims FERC does not say in

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[3]The Flood Control Act, 16 U.S.C. § 825s, states:

> Electric power and energy generated at reservoir projects under the control of the Department of the Army . . . not required in the operation of such projects shall be delivered to the Secretary of Energy, who shall transmit and dispose of such power and energy in such manner as to encourage the most widespread use thereof at the lowest possible rates to consumers consistent with sound business principles. . . . Rate schedules shall be drawn having regard to the recovery . . . of the cost of producing and transmitting such electric energy, including the amortization of the capital investment allocated to power over a reasonable period of years. Preference in the sale of such power and energy shall be given to public bodies and cooperatives. The Secretary of Energy is authorized . . . to construct or acquire, by purchase or other agreement, only such transmission lines and related facilities as may be necessary . . . to make the power and energy generated at said projects available in wholesale quantities for sale on *fair and reasonable terms and conditions* to facilities owned by the Federal Government, public bodies, cooperatives, and privately owned companies.
>
> (Emphasis added.)

Opinion No. 250 that "fair and reasonable" is a ratemaking standard, but only that it is part of FERC's inquiry on review of the NF-1 and 2 rates. *See* Opinion No. 250, 36 F.E.R.C. ¶ 61,335, at 61,820 n.20.[4]

[3] The other California parties recognize the distinction BPA makes.[5] On reading section 825s, we agree that it does not refer to ratemaking per se, but rather to the overall requirement of fairness in the delivery of power by the BPA. BPA's interpretation is reasonable. Therefore, no "fair and reasonable" standard is applicable to ratemaking.

Whether FERC Could Hold An Evidentiary Hearing In Its Review Of The Nonfirm, Nonregional Rates

[4] The Northwest parties contend FERC violated section 7(k) by failing to base its review of the NF-1 and 2 rates solely on the BPA administrative record. They claim arguments were raised and evidence was presented at the FERC hearing that were not before BPA when BPA decided the nonfirm rates.[6]

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[4]In note 20, FERC states: "The Commission noted [in other hearings on rates] that the question of whether BPA had made power available to extraregional customers on fair and reasonable terms and conditions was part of the inquiry in reviewing extraregional rates."

[5]"In addition [to the four standards enumerated above] for those rates to warrant approval [by FERC] BPA must make nonfirm energy available on 'fair and reasonable' terms and conditions." California Public Utilities Commission Opening Brief at 7.

"[FERC] has also specified that the nonregional rates it reviews under Section 7(k) must be 'fair and reasonable.' " California Utilities Opening Brief at 19.

[6]As examples, the Northwest parties state the California utilities objected for the first time before FERC, and now contend before us, that fish and wildlife costs should not be included in the nonfirm rates. The Northwest parties also claim the California utilities agreed at the BPA rate case that BPA should adopt one nonfirm rate for all customers, but then told FERC that the law requires a special nonfirm rate for nonregional sales. Northwest Parties' Reply Brief at 11-12, n.11.

[5] FERC claims that section 7(k) does not limit its review to the BPA record, but in the last sentence provides for an additional hearing, which must be given effect. FERC says it has discretion to decide what type of hearing is necessary, and that its interpretation is entitled to deference, because of its ultimate responsibility for administering section 7(k).[7]

In relevant part, section 7(k), 16 U.S.C. § 839e(k), states:

> Notwithstanding any other provision of this chapter, all rates or rate schedules for the sale of nonfirm electric power within the United States, but outside the region, shall be established . . . in accordance with the procedures of subsection (i) of this section. . . . [S]uch rates or rate schedules shall become effective after review by the Federal Energy Regulatory Commission for conformance with the requirements of such Acts and after approval thereof by the Commission. Such review shall be based on the record of proceedings established under subsection (i) of this section. The parties to such proceedings under subsection (i) of this section shall be afforded an opportunity by the Commission for an additional hearing in accordance with the procedures established for ratemaking by the Commission pursuant to the Federal Power Act [16 U.S.C.A. § 791a et seq.].

As we see it, there are four arguments against FERC's authority to hold a separate evidentiary hearing. First, subsection (i) describes the procedures the BPA Administrator must follow to establish rates. 16 U.S.C. § 839e(i). The subsection requires BPA to hold one or more hearings "to

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[7]FERC has stated that evidentiary hearings will not necessarily be held in all section 7(k) proceedings, but rejects the contention that the language of section 7(k) does not permit them. *See* 23 F.E.R.C. ¶ 61,469, at 62,024 (1983).

develop a full and complete record." 16 U.S.C. § 839e(i)(2). No party disputes that these hearings are to be evidentiary. *See* 16 U.S.C. §§ 839e(i)(2)(A), (B); 16 U.S.C. § 839e(i)(3). The rates are then proposed by BPA and published in the Federal Register, after which additional hearings subject to the same procedures may be held. 16 U.S.C. § 839e(i)(4). Then, the BPA Administrator makes a final decision based on the record, which "shall include a full and complete justification of the final rates . . . ." 16 U.S.C. § 839e(i)(5). Therefore, section 7(k)'s statement that FERC review shall be based upon "the record of proceedings established under subsection (i) of this section" limits FERC review to the BPA record.

Second, this court's review is to be based solely on the BPA record. Section 839f(e)(2) of the Regional Act specifies that the scope of our review of "final determinations regarding rates under section 839e of this title shall be supported by substantial evidence in the rulemaking record *required by section 839e(i)* of this title considered as a whole." 16 U.S.C. § 839f(e)(2) (emphasis added). It would be anomalous for this court to consider another record established by FERC given this statutory mandate.

Third, to permit an evidentiary hearing is inconsistent with this court's precedent regarding FERC review as appellate in nature under 7(k):

> A Federal Power Act rate case is a *de novo* proceeding . . . in which FERC holds an evidentiary hearing and bases its decision solely on the record compiled at that hearing. 16 U.S.C. § 824d. FERC may accept, reject or modify the . . . proposed rates. By contrast, a nonregional rate hearing is a form of appellate review, based on the record previously developed by the BPA in the administrative rate proceeding below. FERC may not modify the proposed rate; it may only confirm or reject it. *Central Lincoln*, 735 F.2d at 1113 n.6; *U.S. Secretary to*

Energy, Bonneville Power Administration, 13 F.E.R.C. ¶ 61,157 at p. 61,339 (1980).

Southern Cal. Edison, 770 F.2d at 784 n.3. Moreover, the Supreme Court has made the following observation about FERC's role in final approval and confirmation of the federal hydroelectric rates:

> FERC views its role in this process as "in the nature of an appellate body," 45 Fed. Reg. 79545, 79547 (1980); its function is to determine from the record before it whether "due process requirements have been met and [whether] the Administrator's program of rate schedules and the decision of [the Assistant Secretary] are rational and consistent with the statutory standards." *Ibid.* In exercising that appellate function, FERC relies on the record before it, remanding for supplementation if necessary.

United States v. City of Fulton, 475 U.S. 657, 663 (1986). Although *City of Fulton* does not interpret section 7(k), but rather section 5 of the Flood Control Act of 1944, 16 U.S.C. § 825s, this decision provides some guidance on FERC's role in reviewing proposed rates. *City of Fulton* describes how hydroelectric rates are developed by the Power Marketing Administrations (PMAs)[8] and are then approved on an interim basis by the Assistant Secretary of Energy before final confirmation and approval by FERC. *Id.* at 662-63.

Finally, we note that according to section 7(k), FERC's function is to approve or disapprove the rates BPA sets; it may not impose other rates of its own. *Central Lincoln*, 735 F.2d at 1113 n.6. Given this limitation, another evidentiary hearing seems superfluous.

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[8]BPA is the "biggest and most important" of the five PMAs. *United States v. Tex-La Elec. Co-op., Inc.*, 693 F.2d 392, 394 n.3 (5th Cir. 1982).

On the other hand, a literal reading of the last sentence of section 7(k) appears to allow an evidentiary hearing before FERC, because the additional hearing section 7(k) provides for under the procedures of the Federal Power Act is a de novo proceeding in which FERC takes evidence. *Southern Cal. Edison*, 770 F.2d at 784 n.3. However, this interpretation is at odds with the statement that FERC review "shall be based on the record of [the BPA proceedings]." 16 U.S.C. § 839e(k). It does not comport with FERC's limited role to approve and confirm BPA's rates, especially when it may lead to the introduction of evidence that BPA did not consider. A "basic rule of statutory construction is that one provision should not be interpreted in a way which is internally contradictory or that renders other provisions of the same statute inconsistent or meaningless." *Hughes Air Corp. v. Public Util. Comm'n*, 644 F.2d 1334, 1338 (9th Cir. 1981).

FERC held the evidentiary hearing in this case because:

> [W]e find that significant questions have been raised by the parties regarding whether these schedules meet the standards set forth in the applicable power marketing statutes. Based on the record presented, we cannot make a determination as to whether the revenue level proposed to be collected or the basis upon which the rate schedules have been designed is appropriate. We shall therefore set these matters for hearing.

U.S. Dep't of Energy—Bonneville Power Admin., 23 F.E.R.C. ¶ 61,161, 61,354 (1983).

Both the Northwest parties and BPA opposed FERC's proposed evidentiary hearing.[9] In forceful arguments accusing

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[9]We note that BPA does not challenge this issue on appeal. But BPA points out in its brief that FERC review is "appellate in nature and must be based on BPA's record."

FERC of making unsound policy, BPA maintained that: (1) section 7(k) requires FERC review to be based on the record of the BPA hearing; (2) section 7(k) does not mention a "hearing on the record" or legally require it; (3) redundant evidence delays Commission review; (4) the Federal Power Act does not require an evidentiary hearing; (5) the only reason to hold an evidentiary hearing would be if a party could demonstrate it was not provided with an opportunity to present its views in the BPA hearing; (6) FERC should defer to the BPA's interpretation of section 7(k) since BPA is the specialized agency Congress designated to establish rates; and (7) rather than holding evidentiary hearings, FERC should have requested briefing from the parties if it had trouble assessing BPA's 30,000 page administrative record.[10]

[6] Although the Regional Act is no model of clarity, and the question is close and very difficult, we are persuaded that FERC should not have held this evidentiary hearing upon review of the nonfirm rates because FERC thought the BPA record was inadequate and wanted to supplement it. *See* 23 F.E.R.C. ¶ 61,469, at 62,024. Congress designed the Act to prevent protracted legal challenges to BPA's ratemaking decisions. *Central Lincoln*, 735 F.2d at 1114. This objective is not served by multiple evidentiary hearings at different agencies. FERC's interpretation is unreasonable in light of the Act as a whole, because that interpretation renders meaningless the Regional Act's provisions for *BPA* to develop "a full and complete record," 16 U.S.C. § 839e(i)(2); for *BPA* to come to a final decision based on the record, which includes a complete justification for the rates, 16 U.S.C. § 839e(i)(5); and for FERC review and approval "based on the record of [BPA's]

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[10]FERC responded "[t]here may be merit to BPA's argument that such an additional hearing need not be an evidentiary hearing and that the mandate of [section 7(k)] may be fulfilled, instead, by providing the parties with the opportunity to file briefs of written comments." 23 F.E.R.C. ¶ 61,469, 62,024 (1983). Nevertheless, FERC decided to hold an evidentiary hearing to supplement the record, attempting to avoid duplication of the BPA record. *Id.*

proceedings established under [16 U.S.C. § 839e(i)]." 16 U.S.C. § 839e(k).[11]

[7] Our interpretation will also prevent parties from sitting out the BPA hearings, as happened here, in contravention of the Regional Act. Moreover, this interpretation does not make insignificant the requirement that BPA develop a complete record for FERC review, or render meaningless the additional hearing before FERC provided for by section 7(k). *See Hughes Air Corp.*, 644 F.2d at 1338; *Ruiz v. Morton*, 462 F.2d 818, 820 (9th Cir. 1972) ("statutes are to be given, wherever possible, 'such effect that no clause, sentence or word is rendered superfluous, void, contradictory or insignificant' " (quoting *Rockbridge v. Lincoln*, 449 F.2d 567, 571 (9th Cir. 1971)), *aff'd*, 415 U.S. 199 (1974). It does not alter FERC's scope of review. We note that the House Committee Report on section 7(k) states that: "FERC's review will be based on the BPA record and on any subsequent FERC proceedings." H.R. Rep. No. 976, 96th Cong., 2d Sess., pt. I, at 70 (1980). *See* 23 F.E.R.C. ¶ 61,469, at 62,025 n.2.

Although BPA argued that FERC may hold evidentiary hearings under section 7(k) only when a party can demonstrate it was not provided an opportunity to present its views adequately during the BPA hearing, we need not reach this issue. We decide here only that FERC may not hold an evidentiary hearing to supplement a record it thinks is inadequate. Our ruling does not mean, however, that an evidentiary hearing could not be held under other circumstances.

[8] Since FERC's procedural error made its review overly broad, we need not remand, but proceed instead to the merits so that this legal challenge is not further protracted.

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[11]The opinion FERC cites, *Pacific Gas & Elec. Co. v. FERC*, 746 F.2d 1383 (9th Cir. 1984), to show that FERC has discretion to decide the type of hearing, is distinguishable. That case arose under the interpretation of a contract for transmission service, not under section 7(k).

Whether BPA's Rates For Nonfirm Energy in the NF-1 and 2 Schedules Violate Section 7(k) of the Regional Act

To uphold FERC's decision, this court need not find that BPA's and FERC's construction of the relevant provisions of the Regional Act is the only reasonable construction, or that it is the one we would have adopted had construction been committed to the judiciary in the first instance. *California Energy*, 807 F.2d at 1459. The only requirement is that the agencies' interpretation of the Act be reasonable. *Id.*

Because this court must defer to FERC and the BPA in ratemaking cases, we must determine whether section 7(k), its legislative history, and the preexisting Acts whose ratemaking standards 7(k) incorporates prohibit the ratemaking decision that is challenged.[12] If not, the inquiry is whether the agencies' interpretation is a reasonable one, and if there is substantial evidence to support it. If so, the decision on the issue may be affirmed.

A. *Whether The Nonfirm Rates To Nonregional Customers May Include The Full Cost of BPA's System*

[9] The main contention of the California parties is that BPA could not reasonably include its full capacity and energy costs in the NF-1 and 2 rates, and do so on an unweighted, proportional basis.

FERC determined it was undisputed that BPA operates its system to maximize the production of useful energy, 36 F.E.R.C. ¶ 61,335, at 61,802, which more often than not results in the production of nonfirm energy that is sold to California.[13] FERC decided that the incremental cost of non-

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[12]Some parties argue that BPA is entitled to no deference. *See, e.g.*, California Utilities Reply Brief at 10. Such a position does not comport with Supreme Court precedent or precedent in this circuit. *See infra*. pp. 4805-06.

[13]This power was sold cheaply under the rates in question, considering what the record shows the California parties would otherwise have paid.

firm energy, which is what the California parties want the rate based upon, is impossible to determine because water in the reservoirs that produces nonfirm energy results not just from stream inflow, but from the use of thermal generating plants and conservation as well. Thus, the actual source of a given unit of energy produced cannot be determined. FERC found that its precedent and considerations of equity supported nonregional, nonfirm energy purchasers contributing to BPA's overall costs, since they benefit from BPA's entire system. 36 F.E.R.C. ¶ 61,335, at 61,802. FERC also observed that even if California purchasers have unequal access to BPA power, and subsequently claim it has less value to them, that fact does not affect what it costs BPA to produce the energy. *Id.* at 61,805.

[10] The California parties present the same arguments on appeal that FERC has decided. They cite to nothing in the statute that requires the alternatives to BPA's cost allocation they propose, nor have they demonstrated that FERC's decisions were either unreasonable or were unsupported by evidence in the record. In light of section 7(k)'s mandate that rates be set with regard to the recovery of the cost of generation and transmission of electric energy, FERC's approval of BPA's decision to charge full costs to nonregional customers was reasonable and was amply supported by the record. Thus, the California parties may not complain that they are not getting the protection from BPA bias that section 7(k) was enacted to prevent. As long as an agency has considered all the relevant factors and has rationally exercised its discretion in deciding matters of law, there is no reason to disturb its conclusions. *Pacific Gas and Elec. Co. v. FERC*, 746 F.2d 1383, 1386 (9th Cir. 1984).

We adopt FERC's findings and conclusions as our own on this issue, excluding, however, its conclusion that fish and wildlife costs are properly included in the nonfirm energy rates. *See* 36 F.E.R.C. ¶ 61,335, at 61,810-11. This issue was not properly before FERC because it was raised for the first

time at FERC's evidentiary hearing, and we have held that hearing was in violation of section 7(k).

B. *Whether the Costs of the WPPSS Nuclear Plants Should Be Charged to Nonfirm Customers*

The California utilities contend they should not be charged for a facility unless it is actually producing energy. They say FERC properly delineated this inquiry on review when it stated:

> The question is whether the current costs at issue are sufficiently *associated with the current production of energy* marketed as nonfirm energy to purchasers outside the [Pacific Northwest] as to make it reasonable for BPA to include the costs . . . .

Opinion No. 250, 36 FERC ¶ 61,335, at 61,807 (emphasis added).

The California utilities read the phrase "current production" narrowly, contending that costs for the WPPSS plants, none of which produced energy during the time the rates were in effect, and two of which are now mothballed permanently, should not have been included in the rates since the plants did not produce energy during the rate period. The California utilities concede these costs may be included in nonfirm rates if the plants ever produce energy during a rate period at issue.

This argument was not new to FERC. In 1980, when the WPPSS plants were under construction, customers of BPA complained that charges related to BPA's prepayments on the WPPSS plants through debt financing should be deferred to a period contemporaneous with the commencement of service from these units. *United States Sec'y of Energy, Bonneville Power Admin.*, 13 F.E.R.C. ¶ 61,157, at 61,338 (1980). The WPPSS contracts required BPA to pay for its share of

plant capacity on fixed dates whether or not the plants were completed or operating on those dates. *Id.* at 61,337. FERC decided the record supported a finding that the WPPSS costs were proper for inclusion in the rates to its customers in the Pacific Northwest and Pacific Southwest. *Id.* at 61,340. In the present case, FERC reiterated those reasons, which associate WPPSS costs with the current production of energy in the following manner:

> The Commission has previously found that BPA is obligated by its contracts with WPPSS to make payments to WPPSS for those portions of the WPPSS system for which BPA is responsible. The Commission further found that it was proper for BPA to include these costs in current energy cost determinations to its customers because BPA is required by Department of Energy Order No. RA 6120.2 to pay its purchased power costs in the year in which they are incurred. The Commission found that BPA has no legal authority to borrow money with which to pay purchased power costs. Under these circumstances, the Commission found it was appropriate for BPA to include the WPPSS costs in current energy cost determinations as a means of providing sufficient revenue to BPA in order that it could meet its contractual obligations and in order to meet its statutory obligation to amortize Federal investment within a reasonable period of time. The Commission has therefore decided that it is appropriate to include BPA's WPPSS costs in the determination of BPA's current energy costs.

Opinion No. 250, 36 F.E.R.C. ¶ 61,335, at 61,809 (citations to 13 F.E.R.C. ¶ 61,157 omitted).

Significantly, the California utilities do not attack this specific statement. Instead, they reiterate their initial argument

that there should be no charges for non-energy producing facilities.

FERC's rationale comports with the standards for ratemaking in section 7(k). FERC's primary concern during WPPSS construction and after plants 1 and 3 were terminated has been whether BPA could meet its statutory obligation to amortize Federal investment within a reasonable period of time. This concern is in keeping with FERC's role to insure the rates it confirms and approves satisfy the standards in the Acts enumerated in section 7(k). *See infra* p. 4807; 13 F.E.R.C. ¶61,157, at 61,338 ("Under the federal power-marketing statutes, the Commission must determine that proposed rates would provide a sufficient level of revenues to BPA to recover its costs and repay the federal investment within a reasonable period of time."). If BPA has to pay WPPSS contract obligations, but cannot charge for them in its rates until the plants produce energy, it would have to divert revenue from funds that would otherwise go to repay the Treasury. Section 7(k) requires that rate schedules be structured to prevent such a result.

FERC decided nonfirm energy customers should share in the cost of WPPSS, because it found that BPA operates its entire system to maximize the production of useful energy, 36 F.E.R.C. ¶61,335, at 61,802, 61,807, which benefits all BPA customers. This finding is supported by substantial evidence in the record. Further, there is substantial evidence that WPPSS plant capacities were acquired to serve nonfirm energy markets. BPA, 1982 Record of Decision at 118. Therefore, FERC decided the non-production of energy by the plants did not require a different allocation of costs between firm and nonfirm customers. *Id.* at 61,809-10.

BPA's and FERC's decision that WPPSS costs are to be borne by all customers is reasonable. A failure in planned energy production does not change the nature of a system designed to maximize energy production and use. Nothing in

section 7(k) or the standards in the Acts it implements limit such a cost to firm customers only. It is a sound business principle to allocate the cost of the contractual obligations over the widest possible customer base to recover it within a reasonable time period. Further, FERC's designation of the WPPSS costs as an ancillary cost of doing business as a power producer is reasonable and is supported in the record.

The California utilities argue the Regional Act and its legislative history differentiate between regional and nonregional customers with respect to payment for non-production costs such as WPPSS. They argue that several provisions of the Regional Act specifically allocate to regional customers the costs of the Federal Base System resources, which include the WPPSS plants. They maintain there is no equivalent express allocation of these costs in section 7(k) for nonregional customers.

This argument fails because it ignores the standards section 7(k) incorporates from previous Acts that BPA must follow in designing its rates. These broad standards may reasonably be interpreted to allow for non-production costs in nonfirm energy rates, as previously discussed. The WPPSS costs are sufficiently associated with the current production of energy to make their inclusion in the nonfirm rates reasonable.

C. *Whether The Costs of The Residential Exchange Program Should Be Included In The Nonfirm Rates*

Under section 5(c) of the Regional Act, 16 U.S.C. § 839c(c), a residential exchange program is established, under which any Northwest utility with high system costs may sell power to BPA at their average system cost, then purchase from BPA an equal quantity of low cost federal power. The benefits to the participating utilities are to be passed on directly to residential customers. *California Energy*, 807 F.2d at 1460. The Northwest parties argue that costs associated with this program should be included in the nonfirm rates.

[11] FERC determined that Congress wanted the costs of this subsidy to be borne by the direct service industrial customers prior to July 1, 1985. It found that although the Act itself did not specify which customers should share in the cost of the program, legislative history stated Congress' preference: "the loss in revenue to the Administrator is in effect returned by the higher direct service industry rates." 36 F.E.R.C. ¶ 61,335, at 61,812 (quoting H.R. Rep. No. 96-976, pt. I, p. 29 (1980)). This court has also observed that "[t]he cost of this 'money-losing program' ... is largely borne by BPA's direct-service industrial customers." *California Energy*, 807 F.2d at 1460 (citing 16 U.S.C. § 839e(c)(1)). Therefore, we find that, for rates in effect prior to July 1, 1985, the costs of the residential exchange program are not to be assessed against nonfirm energy customers. We adopt FERC's findings and conclusions on this issue.

D. *Whether BPA's Nonfirm Rates Were Designed In Contravention of The Regional Act, Because The Rates For Nonfirm Energy Were Too Low*

[12] Without question, the NF-1 and 2 rates did not recover the cost to produce the nonfirm energy sold to California. BPA capped the NF-1 and 2 rates at cost in the rate design, but also provided for sales below cost. Both BPA and FERC admit the nonfirm rates did not recover the cost of service.[14]

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[14]The full production costs for NF-2 energy was 18 mills/kWh, the set standard rate. The spill rate, used when energy supplies were abundant, was set at 9 mills/kWh, or half the cost of production. Under both the NF-1 and 2 rates, the California parties paid less than Northwest customers for BPA energy. Under the NF-1 rate, the California parties paid 7.7 mills/kWh, while Northwesterners paid 8 mills/kWh. Under the NF-2 rate, the California parties paid 9 mills/kWh, while Northwesterners paid 12 mills/kWh. As a result, the California parties saved $1.5 billion, while BPA realized only $270 million in cumulative NF-1 and 2 revenues. During these rate periods, BPA experienced overall revenue shortfalls in excess of $680 million, which caused BPA to miss interest and principal payments due the Treasury.

However, the issue is whether the rates as *designed*, not the rates as collected, were appropriate under the Regional Act.

The Northwest parties contend the Regional Act mandates BPA to design rates in such a way as to recover its costs. They argue the rates should allow for above-cost rates to offset any sales that are below cost. Otherwise, they claim, the firm customers of BPA are foreed to subsidize the nonfirm customers, because less is subtracted from total system costs to determine the firm customers' final share. The Northwest parties contend the Regional Act precludes firm customers from having to subsidize nonfirm customers by limiting firm rates to the cost of resources needed to serve their loads. *See* 16 U.S.C. § 839e(b)(1). The Northwest parties seek a declaration that section 7(k) requires BPA to recover its cost of service, market conditions permitting.

During FERC review, BPA claimed it did not know, when designing the NF-1 and 2 rates for the first time under the Regional Act, what the value of its energy would be to nonregional customers, or what competitors' prices might be. Consequently, BPA says it designed the rates to avoid the waste of nonfirm energy. While BPA admits it must design nonfirm rates with an eye to cost recovery, BPA maintains the Regional Act does not say how costs are to be allocated among customer groups.

The main issue is whether and to what extent the Regional Act and the Acts incorporated in 7(k) limit BPA's authority to design nonfirm energy rates that may lose money. The ALJ for FERC concluded that there "was no excuse for BPA not designing its nonfirm rates so as to recover the costs fairly allocated to nonfirm energy from nonfirm energy users." 29 F.E.R.C. ¶ 63,039, at 65,113. He concluded that "[t]his failure was a violation of the statutory standard respecting 'the lowest possible rates to consumers consistent with sound business principles.' " *Id.*

FERC, however, disagreed. It found no evidence in the record to support that BPA knew with reasonable certainty when it designed the rates what maximum price California would be willing to pay. FERC said BPA "had to be concerned with establishing a rate that would allow it to market energy under conditions of uncertainty at times when the alternative to selling the energy was waste through spill." 36 F.E.R.C. ¶ 61,335, at 61,818. FERC thought it reasonable for BPA to provide for below cost rates to use at times when BPA could not market or store the energy it had available. *Id.* FERC determined that BPA's rates were consistent with the statutory criteria. *Id.* At the same time, FERC refused to say that BPA was obligated to provide for rates above costs to assure that sales at below-cost rates would be offset. It thought such a requirement would be unreasonable "in light of the latitude in the statutory requirement that the rates be as low as possible consistent with sound business principles." *Id.*

The Regional Act does not set forth how BPA must design its rates to conform to the four standards it must follow, or how costs are to be allocated between regional and nonregional customers. In the absence of a clear legislative command, we must consider whether BPA's rates for nonfirm energy " 'represent[ ] a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute.' " *City of Fulton*, 475 U.S. at 667 (quoting *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 845 (1984)). BPA has three conflicting obligations under the prior statutes that section 7(k) incorporates. First, it must protect consumers by ensuring that power is " 'sold at the lowest possible rates . . . consistent with sound business principles.' " *Id.* at 668 (quoting *United States v. Tex-La Elec. Co-op., Inc.*, 693 F.2d 392, 399-400 (5th Cir. 1982)). Second, BPA must "protect the public fisc by ensuring that federal hydroelectric programs recover their own costs and do not require subsidies from the federal treasury." *Id.* (citing the legislative history of the Bonneville Project Act). Third, BPA must encourage the most widespread use of

energy. The Regional Act does not state that any one of these obligations is more important than the others.

[13] Although the question is very difficult, particularly with hindsight, the NF-1 and 2 rates, as developed, appear to conform to the statutory boundaries. BPA operates its system to maximize the production of useful energy. Not knowing exactly what future market conditions would be when it designed the rates, BPA properly allowed for below-cost rates in conditions where energy might otherwise be wasted. FERC's conclusion is reasonable that the "widespread use" requirement provides BPA with wide latitude in designing nonfirm energy rates. That conclusion comports with this court's previous decision that this "widespread use" standard, which incorporates two of the four standards BPA must use, *see infra* p. 4807, provides BPA with so much discretion that there is no law to apply. *City of Santa Clara, Cal. v. Andrus*, 572 F.2d 660, 668 (9th Cir.), *cert. denied*, 439 U.S. 859 (1978).

This brings the question of whether there is law to apply here to the four standards section 7(k) incorporates. This court has recognized there is "law to apply" if a specific statute limits the agency's discretion to act in the manner that is challenged. *Id.* at 666. The challenged action is BPA's setting rates at below cost, to encourage the most widespread use of its power. The remaining two standards limit BPA's discretion to do so, because they require BPA to also have regard for cost recovery and protect the interests of the United States. Consequently, there appears to be law to apply. This conclusion does not conflict with *City of Santa Clara*, because these two standards were not present in that case. BPA provided for cap rates at the full cost of production as well as below-cost rates in its rate design. This rate design comports with all the statutory requirements. Therefore, FERC's approval of the NF-1 and 2 rates as designed is affirmed.

CONCLUSION

We hold that FERC abused its discretion by holding an evidentiary hearing under section 7(k), in view of the Regional Act's directive that FERC's review should be based on the BPA record, FERC's limited role to approve and confirm the rates, and FERC's role as described by the Supreme Court and this circuit.

On the merits of those issues properly before it, FERC's decision to approve the nonfirm energy rates as developed by BPA is AFFIRMED.

Appendix B

Not For Publication
United States Court of Appeals
For The Ninth Circuit

Aluminum Company of America; ARCO Metals Company;
Columbia Falls Aluminum Company,
Petitioners,

Association of Public Agency Customers,
Petitioner-Intervenor,

vs.

Bonneville Power Administration;
Federal Energy Regulatory Commission;
Repondents,

Portland General Electric Company; Puget Sound Power &
Light Company; Public Generating Pool (PGP),
Respondents-Intervenors.

California Energy Commission,
Petitioner,

vs.

Bonneville Power Administration;
Federal Energy Regulatory Commission;
Respondents.

Public Utilities Commission of the State of California;
Southern California Edison Company; Pacific Gas and Electric;
San Diego Gas & Electric Company;
Department of Water and Power of the City of Los Angeles,
et al.,

Filed June 21, 1990

No. 87-7303
BPA No. EF-81-2011-003
No. EF-82-2011-003

No. 87-7308
BPA No. NF-2 Rates
No. NF-1 Rates

No. 87-7313
BPA No. EF-82-2011-003
No. EF-81-2011-003

ORDER

vs.

Bonneville Power Administration;
Federal Energy Regulatory Commission,
Respondents.

Before: CANBY, THOMPSON, and LEVY, Circuit Judges.

The panel has voted to deny the petitions for rehearing and to reject the suggestions for rehearing en banc.

The full court has been advised of an en banc suggestions and no judge of the court has requested a vote on the suggestions.

The petitions for rehearing are DENIED and the suggestions for rehearing en banc are REJECTED.

Appendix C

[¶ 61,335]

United States Department of Energy—Bonneville Power Administration,
Docket Nos. EF81-2011-003 and EF82-2011-003

Opinion No. 250; Opinion and Order Approving Rates

(Issued September 24, 1986)

Before Commissioners: Anthony G. Sousa, Acting Chairman; Charles G. Stalon, Charles A. Trabandt and C.M. Naeve.

[Note: Initial Decision of the Presiding Administrative Law Judge, issued November 27, 1984, appears at 29 FERC ¶ 63,039.]

Appearances

James P. Fama, R. Michael Austin, John A. Cameron, Jr., and Anne W. Squier for the Bonneville Power Administration

Peter G. Fairchild for the California Public Utilities Commission

Lisa S. Trankley for the California Energy Commission

Paul A. Graham for the Oregon Public Utility Commissioner

Roger J. Holt for the Los Angeles Department of Water & Power, the Public Service Departments of the Cities of Burbank and Glendale, and the Water and Power Department of the City of Pasadena

James C. L. Basendale for the Portland General Electric Company

Allen M. Garten and Max M. Miller, Jr. for the Association of Public Agency Customers

Eric Redman and Matthew Cohen for the Direct Service Industries

Jay T. Waldron and Walter L. Williams for the Public Generating Pool

John D. McGrane, Floyd L. Norton and Mark A. Frazee for the Southern California Edison Company

Harry W. Long. Jr. for the Pacific Gas and Electric Company

Thomas L. Blackburn, Gwendolyn Murphy, Melvin G. Berger, Marilyn L. Doria and Laura K. Sheppeard for the Staff, Federal Energy Regulatory Commission

[Opinion No. 250 Text]

I. Introduction and Background

This Opinion concerns the rates for nonfirm energy sold by the Bonneville Power Administration (BPA) to offsystem customers outside the Pacific Northwest (PNW) region.[1] The rate schedules were submitted to the Commission pursuant to section 7 of the Regional Act.

These cases are the first to come before the Commission under section 7(k) of the Regional Act. Under section 7(k), the Commission is required to determine whether BPA's rates for sales of nonfirm energy to its extraregional customers conform with the standards set forth in the Bonneville Project Act of 1937,[2] the Flood Control Act of 1944,[3] and the Federal Columbia River Transmission System Act.[4] To assure that BPA's extraregional nonfirm rates meet these standards, section 7(k) further requires that parties be afforded an opportunity to be heard by the Commission with regard to the rates.

As noted, the applicable standards for our review of BPA's extraregional nonfirm rates are set forth in the three statutes enumerated in section 7(k) of the Act. Taken together, those statutes require BPA to design rates:

1. having regard to the recovery of the cost of generation and transmission of such electric energy;

2. so as to encourage the most widespread use of BPA power;

3. to provide the lowest possible rates to consumers consistent with sound business principles; and

4. in a manner which protects the interests of the United States in amortizing its investments in the projects within a reasonable period.

U.S. Department of Energy—Bonneville Power Administration, 27 FERC ¶ 61,251 (1984), *U.S. Secretary of Energy, Bonneville Power Administration*, 13 FERC ¶ 61,157 (1980).

In applying these standards, the principal issue before the Commission is whether the Commission should approve or disapprove the rates proposed by BPA and implemented on an interim basis during the period July 1, 1981 to October 31, 1983. The question that we address in deciding this issue is essentially: if the rates are to be based upon BPA's costs, what particular costs may BPA properly incorporate in its nonfirm rates.

We generally agree with the presiding judge in his conclusions about which costs BPA may include in a fixed extraregional nonfirm rate. We disagree, however, with the presiding judge's action in disapproving the proposed rates.

By order dated April 29, 1983 (23 FERC ¶ 61,161), the Commission consolidated Docket Nos. EF81-2011-000 and EF 82-2011-001[5] and set for hearing the question of whether BPA's NF-1 and NF-2 rates for nonfirm energy to extraregional customers[6] met the applicable statutory standards. The presiding judge issued an initial decision in the proceeding on November 27, 1984. (29 FERC ¶ 63,039). Essentially, the judge found that BPA's rates were too low in comparison with the costs that should have been included in developing them; he therefore concluded that they should be rejected. Briefs on exceptions and briefs opposing exceptions were filed by a number of parties.[7]

A. Summary of major holdings of initial decision

The presiding judge held that BPA is not required to base its rates for nonfirm energy on its cost-of-service. (*Id.* at p. 65,077). The presiding judge further held, however, that if BPA's rates for nonfirm energy are to be based upon its costs, it is fair to include capacity costs for both hydroelectric and thermal electric generating capacity in the rates for nonfirm energy on an unweighted basis. (*Id.* at pp. 65,088-89). The presiding judge also held that it is reasonable for BPA to include the costs associated with non-

operating nuclear generating facilities in the nonfirm rates. (*Id.* at p. 65,093). The presiding judge limited costs to be included in rates for thermal capacity, operating and non-operating, to those associated with 3,300 MW of capacity. (*Id.* at p. 65,089). The basis for this limit was the presiding judge's conclusion that 3,300 MW was the maximum amount of additional firm energy capacity that BPA could have obtained by using its nonfirm hydro energy in combination with backup thermal capacity. The presiding judge approved the inclusion in nonfirm rates on an unweighted basis of: (1) the costs of the residential exchange program (*Id.* at p. 65,094); (2) fish and wildlife costs (*Id.* at p. 65,096); (3) deferred interst payments (*Id.* at pp. 65,096, 65,115); (4) thermal energy costs (*Id.* at p. 65,097); and (5) transmission costs (*Id.* at p. 65,097). The presiding judge determined that the record would not permit a finding as to what extent conservation costs should be included in nonfirm rates. (*Id.* at p. 65,095).

In response to the contentions of the California parties that the NF-1 rate schedule provisions were unduly vague as to what the price for nonfirm energy would be, the presiding judge found that there was no ground to conclude that the California purchasers had been harmed by any vagueness in the NF-1 rate schedule. (*Id.* at p. 65,099).

The presiding judge found that BPA could use a rate for nonfirm energy based upon factors other than its costs, but that since BPA had used costs as a basis for developing the rates, evidence as to alternative rate designs was irrelevant. (*Id.* at p. 65,111). In addition, the judge found that assertions as to discrimination by BPA in marketing energy at different rates in the PNW and outside the PNW were beyond the jurisdiction of the Commission. (*Id.* at p. 65,107). Finally, the presiding judge determined that the NF-1 and NF-2 rates should not be approved because BPA had not set them high enough so that it could expect to recover the costs of providing nonfirm energy. (*Id.* at pp. 65,120-21).

B. Overview of BPA's development of the NF-1 and NF-2 rates

A brief preliminary explanation as to how BPA developed the NF-1 and NF-2 rates is helpful. For the NF-1 rates, BPA took the forecast annual cost of hydro generation, added overhead costs and certain Regional Act program costs such as conservation and fish and wildlife, and divided the total by the total amount of energy that it expected to produce in the test period. (Ex. No. 3 at 10). BPA called the resulting rates its nonfirm energy floor rates.[8] BPA used a separate transmission cost component of 2.0 mills per kWh in the NF-1 rate. (*Id.* at 11). This transmission cost component was equal to the average cost of transmission for all of the energy that BPA expected to produce in the period. (*Id.* at 8). In the NF-1 rate schedule BPA also provided for higher rates based on costs incurred by BPA in purchasing power or operating other generating resources if such had occurred since the last date on which BPA reservoirs had been full. The BPA approach under the NF-1 rate schedule was to base such higher rates upon accumulated costs not previously recovered through rates. (*Id.* at 9).

For the NF-2 rates, BPA determined that it would treat virtually all of its forecast costs, with some important exceptions, as related to the production of nonfirm energy. BPA therefore took its forecast costs for producing and transmitting energy from its entire system and divided this total amount by the total energy that it expected to sell in the period. (Ex. No. 4 at 14-15). For both the NF-1 and the NF-2 rates, then, BPA "spread" costs on a uniform basis over all units of energy that it expected either to produce or to sell.[9]

II. Issues Before the Commission

A. BPA may reasonably include generation and transmission costs in its extraregional nonfirm energy cost determination and it may do so on a proportional basis.

BPA's development of its proposed nonfirm energy costs involved two questions. The first is whether particular categories of costs may be said to result from the production and transmission of nonfirm energy, so that such costs may be used in the

development of the nonfirm energy costs. The second question is whether a particular category of BPA's forecast costs may be included in the nonfirm energy cost determination on an unweighted, proportional basis.

Our conclusion on the question of what costs may be associated with the production and transmission of nonfirm energy is that it was reasonable for BPA to treat each unit of energy, firm and nonfirm, as contributing to the costs that BPA included in the development of the NF-2 costs. We disagree with the presiding judge's conclusion (29 FERC at p. 65,089) that BPA's thermal costs should be included in nonfirm costs only to the extent of such costs associated with 3,300 MW of capacity. We also disagree with the presiding judge and find that Congress did not intend that the costs of the residential exchange program be included in costs for nonfirm energy. BPA was reasonable in not including them in the nonfirm costs. Finally, contrary to the holding of the presiding judge, we shall approve the NF-1 and NF-2 rates.[10]

1. The character of BPA's system makes it reasonable to include production and transmission costs in the cost determination for nonfirm energy,

a. BPA's stored hydro system with additional thermal capacity distinguishes it from other systems.

Although we shall discuss the basis for our conclusions separately with regard to each of the major categories of BPA's costs at issue, we want to present initially the general basis for our conclusions. In order to put this discussion in the proper perspective, we first address the aspects of BPA's system that make it relatively unique. The preeminent characteristic that distinguishes BPA's system is that it relies predominantly upon hydro generation (which carries substantial storage capacity) and that it is operated to maximize the production of useful energy. (Finding of Fact No. 2; Ex. No. 2 at 13, 27-28). The storage capacity is sufficient to hold some 40% of the average annual stream-flow of the Columbia River. (Ex. No. 2 at 41).

The BPA hydro system is augmented by nuclear generating capacity. (Finding of Fact No. 2; Ex. No. 2 at 13). BPA may also

purchase capacity in other PNW thermal resources if it anticipates that it will require such resources in order to meet projected loads. (Ex. No. 3 at 18). Therefore, at the beginning of a year-long planning and production period, BPA expects to have available to it during that period a set of energy resources which may include thermal generating capacity, purchases of energy and, most important of all, large quantities of water held in BPA's reservoirs and available for release through BPA's turbines. (Ex. No. 2 at 38-40).

Natural fluctuations in the amount of rain and snowfall in the PNW region occur from year to year. Based on historical streamflows and rain and snowfall levels, BPA can expect that it will have available to it over the period of a year-long operating cycle at least the amount of water that has resulted when streamflows and rain and snowfall have been at a historically low level. This is the so-called "critical" level of water available to BPA. (Ex. No. 2 at 17-20).

b. BPA's incremental cost of energy is impossible reasonably to determine.

BPA's combined stored hydro/thermal system is different from the type of thermal system with which the Commission is usually concerned in reviewing rates. The distinction lies in the fact that BPA's system is energy constrained rather than capacity constrained. BPA has more than enough capacity to meet the maximum demands for energy at any given time. (Finding of Fact Nos. 2 and 8 and Ex. No. 2 at 7, 18, 41-42; 29 FERC at p. 65,087). What BPA lacks is sufficient water to operate its installed generating capacity continually at a maximim rate. (Ex. No. 2 at 18).

Because the system is energy constrained, BPA operates the system with a goal of maximizing the production of useful energy. (29 FERC at pp. 65,087-88; Ex. No. 14 at 6,9, Tr. Vol. 17/pp. 2688-89). As part of its program to maximize energy production, BPA can "store" thermal energy by running its thermal plants and letting water accumulate in its reservoirs to a greater degree than it otherwise would accumulate if BPA had no thermal capacity. (Ex. No. 2G at 18). The ability of BPA to store thermal

energy in reservoirs makes the true incremental cost of energy from BPA's system impossible reasonably to determine at any point in time. (Ex. No. 2G at 18-19, 22). This is because the incremental energy may be thought of as stored thermal energy or it may be thought of simply as stored hydro energy. It is not possible accurately to distinguish between the two.

In the case of a thermal system, the Commission would normally be able to determine the incremental cost of energy. This is true because it is reasonably possible to identify all of the changes in how the system would operate (i.e., which generator increases or decreases output while all others hold constant) when it produces one more or one less unit of energy.

In contrast, if BPA varies the amount of energy that it is producing, it frequently does so by increasing or decreasing the amount of water that it is releasing through its turbines. (Ex. No. 2 at 41). The direct cost changes that occur as a result of such a variation are quite small—on the order of one mill per kWh. (Ex. No. 1 at 15316). However, the total cost to BPA when water (stored energy) is released from a reservoir into a turbine at any given point in time is far different from the more immediate and obvious variable cost of operating the hydro generation. (Ex. No. 2G at 18-19).

BPA projects the total costs of producing a given amount of energy over a particular period of time. (Ex. No. 4 at 14-15). It can calculate an average cost figure from this type of projection, but it cannot determine reasonably the cost of producing particular units of energy during the period. The energy is identifiable as firm or nonfirm only in terms of labels that BPA applies when it markets the energy.[11]

2. Applicable Commission precedent and considerations of equity support a recovery of some portion of BPA's overall costs, capacity and energy, from purchasers of nonfirm energy.

The Commission's conclusion as to what costs may properly be recovered from purchasers of nonfirm energy on an energy basis is supported by several factors. One is that there is Commission precedent under the Federal Power Act[12] for classification of capacity costs as energy related when the capacity in question is

operated to maximize the production of energy. *Minnesota Power & Light Company,* Opinion No. 86, 11 FERC ¶ 61,312, at p. 61,646 (1980). Since energy related costs may properly be included in energy rates, Commission precedent supports BPA's approach.

The presiding judge found that BPA operates its system in conjunction with the systems of other PNW utilities with the purposes of production of firm energy to meet loads. (Finding of Fact No. 16; Ex. No. 2 at 27). The presiding judge further found that the BPA system is planned and operated to maximize energy production. (Finding of Fact No. 18; Ex. No. 14 at 6, 9; Tr. 17/2688-89). The California utilities do not dispute this. (CBE at 75). In Opinion No. 86, the Commission approved the classification as energy-related of hydro costs associated with the maximization of energy production. 11 FERC at pp. 61,646-47. That is, the Commission approved the recovery of such costs proportionately with a requirements purchaser's usage of energy, not capacity.

Commission precedent also provides support for the recovery of capacity costs from purchasers of nonfirm energy. The Commission has allowed such recovery in the past, as these purchasers benefit from the use of such capacity. *Boston Edison Company,* Opinion No. 729, 53 FPC 1545 (1975); *Delmarva Power & Light Company,* Opinion Nos. 185, 185-A, 24 FERC ¶ 61,199, at p. 61,462, 25 FERC ¶ 61,308, at p. 61,696 (1983), *remanded on other grounds, Cities of Newark, et al. v. F.E.R.C.,* 770 F.2d 1131 (D.C. Cir. 1985); *Wisconsin Public Service Corporation,* Opinion No. 194, 25 FERC ¶ 61,101, at p. 61,325 (1983).[13] In addition, the Commission, in approving the 1979 (H-6) BPA nonfirm energy rates, has found that it was reasonable for BPA to recover portions of production costs from purchasers of nonfirm energy. *Bonneville Power Administration,* 23 FERC ¶ 61,740-41 (1983). More recently, the Commission has recognized the interrelated nature of thermal and hydro resources in the production of energy by a utility system, such as BPA, which relies upon both. *City of Tacoma v. Washington Water Power Company, et at.,* 34 FERC ¶ 61,341, at p. 61,637 (1986).

The Commission has also cited considerations of equity in approving the recovery of capacity costs from purchasers of nonfirm energy. It is equitable for purchasers benefitting from capacity to make contributions toward the cost of that capacity. *Illinois Power Company,* 11 FERC ¶ 61,186, at p. 61,384 (1980); *Florida Power & Light Company,* 33 FERC ¶ 61,116, at pp. 61,247-48 (1985). Hence, spreading the costs of BPA's system, operated to maximize energy production, across all energy users for purposes of nonfirm energy cost determination finds analogous support in Commission precedent.

3. The characteristics of BPA's system make proportional allocation of capacity costs to nonfirm energy appropriate.

Having established that it was reasonable for BPA to include the costs of all of its energy and capacity resources in determining the cost of nonfirm energy, the next question is whether it was appropriate for BPA to include the costs in the nonfirm energy cost determination on an unweighted, proportional basis. We find that it was reasonable for BPA to do so. The basis for our finding again is that BPA operates its system to maximize the production of useful energy and that, as a result of its substantial energy storage capability, it is not reasonably possible for BPA to determine the incremental cost of particular units of energy. BPA can only estimate the total cost for a given amount of energy that it expects to produce.

Most questions about allocation of capacity costs arise in situations in which no direct constraint on energy exists. Under that circumstance a utility may construct capacity sufficient to meet expected peak demand. It need not be concerned with whether sufficient fuel will be available to meet that demand once the capacity is constructed. However, in the case of BPA's hydro production facilities, this is not true. BPA cannot expect sufficient water to be available to operate an addition to its hydro capacity whenever it wishes. (Ex. No. 2 at 18, 23). That is, BPA expects that some of its hydro capacity will be idle some of the time because it will lack sufficient water to run all of the capacity all of the time that there are sales opportunities.

The fact that BPA spills water at times is fully consistent with this. If BPA expected to spill water at all times, this would imply that BPA could add generating capacity that it could expect to run all of the time if it wanted. But BPA does not expect to be in spill condition at all times. (*Id.* at 18). BPA is limited in its ability to generate electricity by the amount of water available over the course of a production period, not by its hydro capacity.

BPA measures its ability to market nonfirm energy in terms of the amount of water in its reservoirs. BPA has a series of reservoir content guides that it uses to determine when it can sell nonfirm energy. (*Id.* at 32). But these content guides do not measure the cost that BPA has incurred in having a given water content in its reservoirs capable of generating a certain amount of energy.

A given energy content for BPA's reservoirs at a particular point in time could be the result of any one of a number of sequences of prior actions by BPA in operating its various resources and natural variations in water availability to BPA. (*Id.* at 33). Thus, starting with the time at which energy is forecast for a given point in time during the operating period, it may turn out in the intervening period that water availability is less than average, so that BPA produces more energy from its thermal resources. Alternatively, water availability may be greater than average, while demand for energy is such that BPA must cut back on operation of its thermal resources. (*Id.* at 38-39).

Under either alternative, the energy content of BPA's reservoirs at the point in time is the same, so that BPA can expect to market the same amount of energy under either alternative. However, the costs that BPA has incurred in the intervening period are quite different for the two alternatives. The result is that BPA cannot, at the beginning of a production planning period. reasonably determine the cost of a particular incremental unit of energy to be produced at some point during the production period. All that BPA can reasonably do is project total costs for producing a total amount of energy over the course of the production planning period.

Under present circumstances, because BPA operates its system to maximize the output of useful energy and because, as a result

of this, BPA cannot reasonably determine the cost of particular incremental units of energy, we conclude that it is reasonable for BPA to spread all costs of hydro and thermal over total energy for the purpose of developing nonfirm energy costs.

Hereafter we consider on an individual basis many of the cost components included in nonfirm energy cost determination by BPA about which the parties offered separate arguments. Our general conclusion is that all of the separate cost components are reasonably included in the nonfirm rates on an unweighted, proportional basis because of the findings discussed above. Nevertheless, we address the arguments separately, partially because the parties have made them separately, and partially because there are minor distinctions among the various cost components that need to be considered.

4. The California parties' priority arguments do not persuade the Commission that BPA has acted unreasonably in pricing its nonfirm energy on the basis of a proportional, unweighted inclusion of production and transmission costs.

The first argument by the California parties against the proportional, unweighted inclusion of production costs in the extraregional nonfirm cost determination is based upon the priority given to the PNW in the marketing of BPA nonfirm power. This argument is that there are two separate classes of nonfirm energy, regional and extraregional, and that it is wrong to have the same rate for the different types of nonfirm energy. According to the California parties, nonfirm energy is only sold to them under very restricted circumstances, in particular when BPA cannot store water to use it later to produce energy for sale in the PNW. This is a result of the Regional Preference Act.[14] This means, according to the California parties, that nonfirm energy can be sold outside the PNW only when it would otherwise be wasted. (CBE at 78). They contend that the only identifiable cost that BPA incurs in producing energy that is marketed as nonfirm energy to California purchasers is the incremental production cost of hydro generation, less than one mill per kWh. (*Id.* at 81). In our view, this argument must be rejected.

We disagree with the assertion of the California parties that the statutory marketing policy required of BPA means that there are two separate types of nonfirm energy with two separate costs. We find that it is reasonable for BPA to treat the energy that it expects to produce as a single commodity, no matter whether it is sold in the PNW or outside the region or as firm or nonfirm energy. BPA has a single system from which it produces energy.

When the energy is produced, BPA must follow statutory policies in marketing the energy. But such policies do not determine the costs of producing the energy in the first place. The statutory priorities certainly may affect the value of the energy to purchasers, just as the alternatives available to the purchasers affect the value of the energy to them. (Ex. No. 2 at 49). The question of what are the costs of producing and delivering energy is logically separate from what policy BPA should follow in marketing a given amount of energy, firm or nonfirm. If the statutorily-imposed order of priority for customers were suddenly eliminated, there would be no impact on BPA's costs for nonfirm energy. Under the circumstances, where the question is what costs may properly be included in the cost-determination for nonfirm energy, it was reasonable for BPA to treat the nonfirm energy as the same commodity and to have a single rate for nonfirm energy, whether sold in the PNW or outside the region, as the presiding judge found. (29 FERC at p. 65,076).

A second argument by the California parties against a nonfirm energy cost determination that includes capacity costs on an unweighted, proportional basis is that the nonfirm energy is sold outside the PNW only when the alternative is to spill the water. (CBE at 85). This argument must be rejected because it is simply a variation on the priority argument dealt with above.

The argument by the California parties is based on the premise that the costs of some of the nonfirm energy (that sold outside the PNW) can be separated from the costs of the rest of BPA's energy (that sold within the PNW). We have previously noted that the determination of the costs that may reasonably be attributed to the production of energy is logically separate from the question of the marketing policies that BPA is required by statute to follow.

If the "spill condition" argument by the California parties is that the nonfirm rate should not include capacity costs because the only alternative to selling the energy is wasting it, the argument must be rejected because it ignores the way in which BPA operates its system. It ignores all of the BPA actions and investments that lead up to the availability of the nonfirm energy. Moreover, the evidence shows that the California purchasers were offered nonfirm energy when BPA was not in a spill condition. (Ex. 4G at 59). BPA markets outside the PNW before it has exhausted the demand for nonfirm energy within the PNW. This was made clear by the responses on cross-examination of BPA witness Mr. Pollack when he described BPA's marketing of nonfirm energy under the Regional Preference Act. (Tr. Vol. 17/pp. 245-46).

The point is that BPA reasonably expects to have available a certain amount of energy as a result if its operation of its entire system. BPA must recover the costs reasonably associated with the production of this energy from the purchasers. We do not think that the fact that California purchasers have unequal access to purchase nonfirm energy or that the value of the energy is different to different purchasers affects the costs of that energy in any way.

B. Remaining California arguments against inclusion of hydro capacity costs in nonfirm energy rates on an unweighted, proportional basis must be rejected.

It is the position of the California parties that the incremental operating cost per unit of producing electricity from BPA's hydroelectric facilities is the only proper cost to include in the nonfirm energy cost determination. (CBE at 82-83). The California parties argue that it is wrong to include hydro capacity costs on an unweighted, proportional basis in the nonfirm cost determination because the record evidence shows that BPA's hydro system was built to serve BPA's firm customers and its regional nonfirm customers. (*Id.* at 83).

The California parties also argue that the presiding judge's finding that BPA's system is energy-constrained rather than capacity-constrained does not justify the inclusion of hydro capac-

ity costs on an unweighted, proportional basis. (*Id.* at 86). They argue that BPA is not energy-constrained when it is in a spill situation, which is when BPA sells nonfirm energy outside the region. (*Id.* at 86). Conversely, the California parties argue, BPA is unable, at times when it is energy-constrained, to make sales outside the PNW because of the Regional Preference Act. (*Id.* at 86).

Finally, the California parties argue that the ability of BPA to shape the availability of nonfirm energy is not justification for inclusion of BPA's hydro capacity costs, because there is no evidence that BPA uses its hydro capacity to shape the availability of nonfirm energy into the peak demand periods of the California purchasers.[15] The California parties assert that the Commission's opinion in *Kentucky Utilities,* 15 FERC ¶ 61,002, *reh'g denied,* 15 FERC ¶ 61,222 (1981) and the opinion of the court in *Fort Pierce Utilities Authority v. F.E.R.C.,* 730 F.2d 778 (D.C. Cir. 1984), establish that inclusion of capacity costs is warranted only when such customers actually take service during periods of their own peak demands. (*Id.* at 86-87).

The California parties also assert that there is no record support for the presiding judge's conclusion that BPA's attempted maximization of nonfirm energy production results in a predictable supply of nonfirm energy around which nonregional purchasers can plan their systems. The California parties argue that the nonfirm energy is typically unavailable to nonregional purchasers during the purchasers' annual peak periods. (*Id.* at 87). The California parties argue further that the availability of nonfirm energy from BPA to nonregional purchasers is erratic (*Id.* at 88), both because of variation in water conditions and because of statutory restrictions on the availability of nonfirm energy outside the PNW.

We have considered the arguments of the California parties as to hydro capacity costs and we have determined that BPA's unweighted, proportional inclusion of hydro capacity costs in the nonfirm rates was reasonable and that the California arguments against it should be rejected. First, concerning the argument that BPA's hydro system was not built to serve the California parties, we view our purpose here as determining the costs of nonfirm

energy, thus we believe that the purpose for which the hydro system was originally constructed is not pertinent to the question of whether the hydro system is currently used to produce nonfirm energy. If the hydro capacity is currently used to produce nonfirm energy, it is proper to include costs of that capacity in the cost determination for nonfirm energy. Second, the spill argument of the California parties has been dealt with previously. (*Supra* at 14).

Finally, we view as irrelevant the California parties' arguments that BPA has not shown that it shapes the availability of hydro energy to meet peak demands on the California purchasers' systems so that it is not correct to include hydro capacity costs in the nonfirm rates. The basis for our finding that it is reasonable for BPA to incorporate hydro capacity costs on an unweighted, proportional basis is the fact that the system is energy constrained (and operated to maximize energy production) rather than capacity-constrained.

Our finding is not based upon the use of a peak responsibility method for assigning supplier costs. In any event, the prior Commission cases cited by the California parties are not relevant because they concern cost determinations reflecting the suppliers' peaks rather than the customers' peaks.

C. Remaining California arguments against the inclusion of thermal capacity and energy costs in the nonfirm energy rates are not persuasive.

1. The arguments of the California parties

The second disputed category of capacity and operation costs included in the nonfirm cost determination on an unweighted, proportional basis is the costs for thermal energy and capacity, from BPA's own system and purchased from other utilities. The California parties argue against the inclusion of these costs in the nonfirm cost determination for some of the same reasons that they oppose the inclusion of hydro capacity costs.

Thus, the California parties argue that there is no evidence to show that the costs of thermal baseload capacity were incurred by BPA for the purpose of providing nonfirm energy outside the

PNW (CBE at 93). They also argue that the presiding judge should have set a limit on the amount of thermal capacity and energy costs that could be included in the nonfirm rates much lower than the limit of 3,300 MW which he imposed. They contend that the basis for the 3,300 MW figure was evidence about the amount of nonfirm hydro capacity that could be "firmed up" for the entire PNW, not for BPA only. They contend that the amount for BPA is considerably less. (*Id.* at 94).

The California parties also contend that it is wrong for BPA to include expected purchased power and thermal energy costs in the nonfirm cost determination. Their position is that such costs may properly be included in the cost determination for rates for sales of nonfirm energy to extraregional customers only when thermal resources are operated by BPA in order to make a sale of nonfirm energy. The California parties contend that BPA operates thermal resources only to maintain its reservoirs at levels sufficient to insure that BPA will be able to produce the average amount of firm energy that BPA expects from its hydro system. The California parties characterize as "absurd" the suggestion that BPA operates thermal resources in order to store water in reservoirs so that a spill condition will result to that BPA may then sell nonfirm energy to customers outside the PNW region. (*Id.* at 102). The California parties contend that BPA's unweighted, proportional inclusion of expected purchased power and thermal energy costs in its cost determination for nonfirm energy sold outside the PNW cannot be supported on the basis of any measure of fairness or cost-of- service ratemaking principles. (*Id.*)

2. Discussion

The basic question here is whether it was reasonable for BPA to include in its nonfirm energy cost determination on an unweighted, proportional basis the capacity and energy costs for thermal energy that BPA expected to incur during the test period. For the reasons previously stated, we find that it is reasonable to include them.

The California parties argue that, because there has been no showing that capacity was built for the purpose of providing

nonfirm energy outside the PNW, the thermal capacity and energy costs may not be included in BPA's nonfirm energy costs. We view this argument as irrelevant. The question is whether the current costs at issue are sufficiently associated with the current production of energy marketed as nonfirm energy to purchasers outside the PNW as to make it reasonable for BPA to inlcude the costs in the nonfirm energy cost determination and to do so on an unweighted, proportional basis. We agree with the California parties that BPA does not operate its thermal capacity so that it will have energy that must be spilled if it cannot be sold. BPA operates its entire system, including its thermal capacity, to maximize the production of useful energy. More specifically, BPA operates its thermal capacity for purposes of assuring a supply of water for firm energy purposes. this water may ultimately be used for non-firm energy production. (Ex. No. 2G at p. 19). It is appropriate to include the costs of BPA's entire system in the cost determination for this energy.

The California parties argue that the maximum quantity of thermal capacity and energy costs that could possibly be included in the nonfirm energy rate should be much less than the limit of 3,300 MW established by the presiding judge. We do not find that any such restriction on BPA's cost determination is justified. We shall discuss our reasons for this conclusion below.

D. The 3,300 MW limitation on inclusion of nuclear construction and conservation costs will be rejected.

The presiding judge imposed a limit on the costs for nuclear capacity under construction and conservation costs that BPA could include in the nonfirm energy cost determination. (29 FERC at p. 65,093). He held that the construction of nuclear capacity and the conservation expenditures could benefit non-firm energy customers only up to the amount of nonfirm energy that would continue to be available because of the nuclear capacity and conservation. He found this amount to be 3,300 MW. (*Id.* at p. 65,094, p. 65,095). The judge imposed this limit because he held that the construction of thermal energy plants and conservation had kept the supply of nonfirm energy higher than if a more low-cost capital strategy of adding capacity had been employed. (*Id.* at p. 65,093).

Since the presiding judge found that BPA could not have used such low capital cost facilities for the total amount of thermal energy actually employed to meet its firm energy demands, he limited the amount of non-hydro capacity and conservation costs to be allocated to nonregional nonfirm customers to 3,300 MW. We have followed a somewhat different line of reasoning than the presiding judge in concluding that the nonfirm customers should be allocated thermal capacity costs and conservation costs. In light of our reasoning, we do not find that a 3,300 MW limitation is either necessary or logical. In view of the evidence in the record, we find that it is reasonable for BPA to allocate on an unweighted, proportional basis all of its projected costs for thermal capacity and energy to all of its customers, firm and nonfirm.

As we have previously noted, it is not possible to conclude that BPA incurs thermal costs only to produce firm energy. We have previously found that BPA's nonfirm energy may reasonably be treated as the product of BPA's entire system. Moreover, BPA uses thermal energy to maximize output of both firm and nonfirm energy. Since the nonfirm energy is to be treated as the product of BPA's entire system, including all of BPA's thermal capacity and energy, there is, in our view, no basis for the 3,300 MW limit imposed by the presiding judge. We shall therefore reverse the presiding judge on this point.

E. BPA properly included the costs for its network transmission system in the nonfirm energy cost determination on an unweighted, proportional basis.

The presiding judge approved the inclusion of the costs of BPA's transmission system in the nonfirm cost determination on an unweighted, proportional basis. He concluded that the integrated BPA transmission system was involved in supplying energy to purchasers outside the PNW. (*Id.* at p. 65,098). On exceptions the California parties make essentially the same arguments against this result that they make with regard to the inclusion of BPA's hydro and thermal capacity and energy costs and we reject these arguments for the same reasons as in connection with those costs.

F. BPA may properly include its costs asssociated with the Washington Public Power Supply System in its nonfirm costs.

The California Utilities, the CEC. and CPUC, and the Commission trial staff take exception to the presiding judge's finding (*Id.* at p. 65,094) that BPA reasonably included in its NF-2 nonfirm energy cost determination the test period costs associated with BPA's involvement in the Washington Public Power Supply System (WPPSS). We affirm the presiding judge in this respect.

The WPPSS costs are based upon three nuclear power plants owned by WPPSS. BPA has entered into contracts with WPPSS for shares of the output of the plants when they go into operation. (Ex. No. 4 at 17-18). Construction on two of the plants was suspended during the NF-2 period, while the third was projected to be completed in 1984 after the NF-2 rates were replaced by subsequently filed rates. (Tr. Vol. 5/pp. 785-60; Ex. No. 4G at 49). No party took exception to the statement by the presiding judge that WPPSS No. 1 and No. 3 plants may never be completed. (29 FERC at p. 65,093).

The Commission has previously found the BPA is obligated by its contracts with WPPSS to make payments to WPPSS for those portions of the WPPSS system for which BPA is responsible. *United States Secretary of Energy, Bonneville Power Administration,* 13 FERC ¶ 61,157, at p. 61,340 (1980). The Commission further found that it was proper for BPA to include these costs in current energy cost determinations to its customers because BPA is required by Department of Energy Order No. RA 6120.2 to pay its purchased power costs in the year in which they are incurred. The Commission found that BPA has no legal authority to borrow money with which to pay purchased power costs. Under these circumstances, the Commission found it was appropriate for BPA to include the WPPSS costs in current energy cost determinations as a means of providing sufficient revenue to BPA in order that it could meet its contractual obligations and in order to meet its statutory obligation to amortize Federal investment within a reasonable period of time. (13 FERC at p. 61,340). The Commission has therefore decided that it is appropriate to include

BPA's WPPSS costs in the determination of BPA's current energy costs.

For the same reasons that we found that it is reasonable to allocate thermal and hydro capacity costs to nonfirm customers, we also believe that it is reasonable for BPA to require nonfirm customers to share in the cost of the WPPSS plants. It is also reasonable for BPA to include WPPSS costs on an unweighted, proportional basis for the same reasons as in the case of the other capacity costs discussed previously. As in the case of the thermal capacity and energy costs, and for the same reasons, the presiding judge's limitation on costs to be incorporated in the nonfirm rate to those associated with 3,300 MW of capacity must be rejected. (29 FERC at p. 65,094).

Some parties argue that the fact that two WPPSS plants are "mothballed" should lead to a different result. We do not agree. As noted, the Commission has previously recognized that inclusion of WPPSS costs in BPA's rates is appropriate to ensure that BPA meets its statutory obligation to amortize Federal investments within a reasonable period of time. *United States Secretary of Energy Bonneville Power Administration,* 13 FERC ¶ 61,157 (1980). The fact that two WPPSS plants are currently "mothballed" has not been shown to change BPA's statutory repayment obligation. These costs must be recovered through rates rather than being absorbed by the Federal treasury. Moreover, in fact that the plants are mothballed does not mean that the allocation of costs between firm and nonfirm customers should be any different.

G. BPA properly included costs of its fish and wildlife programs in the nonfirm energy costs.

BPA also included costs of its fish and wildlife programs in the nonfirm costs on an unweighted, proportional basis. (Ex. No. 3 at 10; Ex. No. 4 at 14). The presiding judge approved the inclusion of these costs of the dams that are part of BPA's production system on the basis that they are part of the costs of producing nonfirm energy from that system. (29 FERC at p. 65,096).

On exceptions, the California parties argue that there is no evidence that there is additional energy available to purchasers of

nonfirm energy as a result of fish and wildlife expenditures. (CBE at 103). The California parties further argue that the fish and wildlife costs are a result of the Regional Act and that they therefore may not be included in the determination of nonfirm energy costs for sales to extraregional nonfirm customers because section 7(k) bars such inclusion. According to the California parties, section 7(k) bars inclusion in costs for nonfirm energy sold to extraregional customers of costs of programs mandated by any legislation enacted after the Federal Columbia River Transmission System Act of 1974 (16 U.S.C. §§ 838-838k (1982)). (*Id.* at 103).

The California parties also argue that section 7(g) of the Regional Act bars the inclusion of fish and wildlife costs in nonfirm rates because it requires that such costs be allocated to regional customers. (*Id.* at 103). Section 7(g) of the Regional Act directs that fish and wildlife program costs and other costs be equitably allocated to power rates, to the extent that their allocation is not governed by provisions of statutues enacted prior to the Regional Act or by other provisions of the Regional Act.

We believe that it is reasonable to include fish and wildlife program costs in BPA's nonfirm costs on a porportional, unweighted basis. The California parties do not deny the finding by the presiding judge that the fish and wildlife costs are costs of BPA's dams. (29 FERC at p. 65,096). Although the programs do not directly lead to the production of energy, they are required of BPA in order for it to operate its dams as part of its system which it uses to maximize energy production.

We also reject the argument of the California parties that the fish and wildlife program costs are barred from inclusion in nonfirm energy cost determination by sections 7(g) and 7(k). Concerning the argument as to 7(k), we do not agree. In the absence of express language in section 7(k) that would support the argument of the California parties, we do not think it is reasonable to assume that Congress would intend to bar the inclusion of costs resulting from subsequent congressional or BPA decisions, if otherwise appropriate.

Concerning the section 7(g) argument by the California parties, we agree with BPA that the language and legislative history of section 7(g) do not support the California parties' interpretation. (BBOE at 104). Section 7(g) refers simply to the allocation of costs to power rates and not specifically to allocation of costs to firm power rates.

H. BPA properly included costs for its conservation programs in its NF-2 costs on a proportional, unweighted basis.

BPA also included test period costs for its conservation programs in the NF-2 costs on an unweighted, proportional basis. (Ex. No. 4 at 21). The presiding judge determined that it was not possible to make a finding as to how much of the conservation costs should be included, since the costs should be subject to the same 3,300 MW limit adopted by the presiding judge with regard to the inclusion of thermal capacity and energy costs in th NF-2 rate. (29 FERC at p. 65,096).

On exceptions, the California parties urge that the conservation costs should not be included for nonfirm energy. They contend that BPA's conservation costs are incurred in the hope of reducing future demand for firm energy and that, as a result, there is no impact on BPA's costs for providing nonfirm energy. (CBE at 103). The California parties also make the same arguments with regard to sections 7(k) and 7(g) that they make in the case of BPA's fish and wildlife program costs. (Id. at 103).

On the basis of our review, we have determined that it was reasonable for BPA to include the test period costs for its conservation programs in the NF-2 costs on an unweighted, proportional basis. As we have previously discussed, we disagree with the presiding judge on the 3,300 MW limitation on inclusion of costs in the NF-2 energy cost determination. Therfore, we reject the presiding judge's decision to impose the limit on the inclusion of conservation costs in the NF-2 energy cost determination.

The conservation costs at issue are incurred by BPA to avoid building additional thermal generating resources. (Ex. No. 4 at 46). The conservation program keeps BPA's loads smaller than they otherwise would be. This means that BPA's thermal generat-

ing capacity will be greater relative to its loads than would otherwise be the case. Therefore, it is reasonable to treat the conservation costs similarly to the cost of additional thermal generating capacity. For the same reasons that it is reasonable for BPA to include test period costs for current and future thermal energy and capacity in the nonfirm costs on an unweighted, proportional basis, we find that it is reasonable for BPA to include the test period costs for conservation on an unweighted, proprotional basis.

We reject the arguments of the California parties that the conservation costs are barred by sections 7(k) and 7(g) for the same reasons as discussed previously in connection with the fish and wildlife program costs. We approve the inclusion of the conservation costs in nonfirm costs for the reasons noted above.

I. The costs of the residential exchange program should not be included in BPA's nonfirm rates.

Section 5(c)(1) of the Regional Act provides:

> Whenever a Pacific Northwest electric utility offers to sell electric power to the Administrator at the average system cost of that utility's resources in each year, [BPA] shall acquire by purchase such power and shall offer, in exchange, to sell an equivalent amount of electric power to such utility for resale to that utility's residential users within the region.

As the presiding judge noted (29 FERC at p. 65,094) the thrust of this program is to permit PNW utilities to supply their residential customers with cheaper BPA power. The issue here is whether to assign some of the costs of this exchange program to the nonfirm customers.

BPA did not assess these costs to the nonfirm customers in its proposed rates. The presiding judge, however, held that the costs of the residential exchange program should have been included in the NF-1 and NF-2 costs. (*Id.* at p. 65,095). He stated that Congress did not specifically identify which of BPA's customers would share in funding the subsidy, and therefore the subsidy should be rolled in with all other operating costs and allocated to all those benefiting from the BPA system. He also cited section

7(g) of the Regional Act, which provides for an equitable allocation to power rates of costs and benefits not otherwise governed by provisions of law, as mandating the inclusion of the residential exchange costs in the nonfirm energy costs. (*Id.*) The California parties except to this ruling; they argue that this result is inconsistent with the intent of the Regional Act; the PNW parties oppose this exception. (CBE at 98, PBOE at 94).

On this issue, we agree with the California parties. We find that the presiding judge was in error in holding that Congress did not specifically state which BPA customers should share in the cost of the residential exchange program. One of the purposes of the Regional Act was to ensure that residential customers of Northwest investor-owned utilities (IOUs) would have rate parity with residential customers of public utilities who have preference rights to BPA's power.

Aluminum Company of America v. Central Lincoln People's Utility District, 467 U.S. 380, (1984), *Public Utilities Commissioner of Oregon v. BPA,* 767 F.2d 622, 624 (9th Cir. 1985). This result is achieved through the exchange program in which IOUs sell power to BPA at their average system cost, and then purchase from BPA an equal amount of lower cost Federal power § 5(c), Regional Act. BPA would, of course, lose money as a result of this exchange. However, Congress intended that BPA was to récoup its losses resulting from these agreements primarily by charging higher rates to its direct service industrial customers (DSIs) until July 1, 1985, § 7(c)(1)(A), Regional Act, *Public Utilities Commissioner of Oregon, supra* at 625, *Pacificorp v. F.E.R.C.,* No. 84-77569, slip op. at 4-5 (9th Cir. July 28, 1986). The House Report sets forth this purpose explicitly: "The loss in revenue to the Administrator is in effect returned by the higher direct service industry rates." H.R. Rep. No. 96-976, pt. I, p. 29 (1980).

Since Congress has indicated that the DSIs should be the primary parties to pay for the subsidy inherent in the residential exchange program, at least during the NF-1 and NF-2 period, we find that it is inappropriate to require that the nonfirm, extraregional customers also contribute to the costs of this program.

The Northwest parties argue, however, that section 7(c) only requires DSIs to pay for these costs through higher rates "to the extent that such costs are not recovered through rates applicable to other customers." In our view, this sentence in section 7(c) of the Regional Act does not require a different result. First, the decisions cited indicate that section 5(c) purchases are supposed to be recovered primarily through higher rates to DSIs. Second, the Senate Report, in commenting on the above language, lists a variety of customers who may share in paying such costs, but does not list nonfirm customers.[16]

Moreover, to the extent that the language of section7(c) is unclear, the purpose of the Regional Act supports BPA's decision to exclude from the nonfirm rates the costs associated with section 5(c) purchases. The residential exchange program is an effort to reallocate resources among various groups in the Pacific Northwest region. It provides a subsidy to the customers of IOUs and relies primarily on another regional group—DSIs—to fund this subsidy. to the extent that BPA is unable to fund this subsidy through higher rates to DSIs, it appears more consistent with these purposes to require other parties in the region to pay for this subsidy rather than extraregional entities.

We, therefore, reverse the judge on this issue. The costs of section 5(c) purchases were reasonably excluded from the NF-1 and NF-2 cost determination.

J. BPA reasonably included amortization of its deferred interest costs in the NF-2 costs.

BPA included an amount in its test period costs for the NF-2 rate to amortize by the end of fiscal 1985 accumulated deferred interest payments owned to the Federal treasury. These deferred interest payments were on amounts invested, by BPA in hydroelectric generating facilities, transmission facilities, and conservation projects. (Ex. No. 4G at 53).

The presiding judge found that the deferred interest amounts arose from BPA's errors in forecasting revenues from sales of both firm and nonfirm energy. (29 FERC at pp. 65,115-16). He concluded that it was appropriate to include the deferred interest amortization in the NF-2 costs on an unweighted, proportional

basis because the amounts by which revenues from firm and nonfirm sales were less than projections in the NF-1 period were proportional to forecasted revenues from firm and nonfirm sales in the NF-1 period. (*Id.* at p. 65,116). The presiding judge also noted that the Commission has followed a policy of "rolling-in" costs such as the deferred interest expense and that the costs were related to facilities that are important to both firm and nonfirm customers. (*Id.*)

The California parties argue on exceptions that the presiding judge has ignored BPA's burden of proof in approving the inclusion of deferred interest expense in the NF-2 costs. They contend that the presiding judge could not properly approve the inclusion of deferred interest expense from the period prior to the NF-1 period because he specifically found that there was no record evidence as to which customer groups were responsible for the deferrals. (CBE at 103-04).

The California parties also contend that the BPA forecast errors in the NF-2 period related primarily to sales of firm energy, so that it is the firm customers who have been responsible for BPA's revenue shortfalls and the corresponding interest deferrals. The California parties assert that nonfirm energy sales have been at rates above what they contend are BPA's incremental costs and that they have therefore kept the deferred interest amount from being larger than it otherwise would have been. (*Id.* at 105).

The trial staff also takes exception to the inclusion of deferred interest costs in the NF-2 costs. It argues that the purchasers of nonfirm energy did not contribute to the deferral during the NF-1 period and that BPA has not presented evidence as to why the purchasers of nonfirm energy should be responsible for deferred interest costs arising before the NF-1 period. The trial staff also makes the argument that the presiding judge has ignored BPA's burden of proof in finding that BPA may attribute the deferral to the nonfirm energy on an unweighted, proportional basis even though there is no evidence as to why BPA had deferred interest payments prior to the NF-1 period. (SBE at 33).

Although we affirm the conclusion of the presiding judge that it was proper for BPA to include these costs in the NF-2 rates on an

unweighted, proportional basis, we do so for a different reason than the presiding judge. The deferred interest payments are on funds advanced to BPA from the Federal treasury to allow BPA to invest in hydroelectric generating facilities, its transmission system, and conservation programs. We have previously explained why it is reasonable for BPA to include test period costs for these portions of its system in the nonfirm energy costs on an unweighted basis. The deferred interest payments on these portions of BPA's system amount to additional test period expenses for BPA's system that produces the energy that BPA markets. For the same reason as with the other test period costs, we find that it is reasonable for BPA to include the deferred interest payment for the test period in the nonfirm costs on an unweighted basis.

The presiding judge based his decision on the deferred interest question in part on an analysis of BPA's forecasts versus actual figures for sales of firm and nonfirm energy in the NF-1 period. (29 FERC at pp. 65,115-16). Our decision, that it was reasonable for BPA to include deferred interest costs in the NF-2 costs on an unweighted, proportional basis, is not based on an analysis of which customer class could somehow be said to be more responsible for deferred interest costs.

K. Approval of the costs used by BPA in determining the NF-2 rate schedule logically requires approval of the costs used in determining the cost of nonfirm energy for the floor rate in the NF-1 rate schedule.

BPA's NF-1 rate schedule provided for a floor rate that was based upon a proportioned, unweighted spreading of BPA's system overhead costs, its hydro capacity and energy costs, its conservation costs, its fish and wildlife preservation costs, and its transmission costs across all the energy that BPA expected to produce with its system. (Ex. No. 3 at 10). The NF-1 rate schedule provided for a higher rate, to the extent that BPA had incurred and not yet recovered costs, beyond those included in the floor rate, since the last time that BPA's reservoirs had been full. (Ex. No. 3 at 9).

BPA included in the cost determination for the NF-2 standard rate some types of costs that it had not included as part of the

costs for the NF-1 rate schedule. At the same time, BPA did include in the cost determination for the NF-2 standard rate all of the costs that it had included in the NF-1 rate schedule. It follows that our approval of the inclusion of a particular type of cost in the cost determination for the NF-2 standard rate means that it was proper for BPA to include the same type of cost in the NF-1 rate schedule. This means that the NF-1 rates were not in excess of cost. The remaining question is whether rates under the NF-1 or the NF-2 rate schedules were so low as to require that we disapprove them. As is discussed below in connection with our approval of the rates, we find that the rates were not so low as to require disapproval of the rates.

L. The question of whether BPA may use share-the-savings rates is not present in this proceeding.

BPA based the rates that it proposed in these dockets on its own incurred costs. As a result, the focus of the proceeding and this opinion has been on BPA's costs. The position of the PNW parties in the proceeding has been generally that BPA should have based its rates on a share-the-savings approach.[17] The have therefore presented evidence on the value of the nonfirm energy as well as BPA's costs. The presiding judge found that the evidence on value of service was not relevant to the NF-1 and NF-2 rates. (*Id.* at p. 65,101). We agree, since the issue is which BPA costs properly may be included in the cost-determination for nonfirm energy. The presiding judge held that while BPA was free to use share-the-savings rates, there was nothing more to be said in the absence of a proposal by BPA to use any form of a share-the- savings rates. (*Id.* at p. 65,111).

The PNW parties take exception to the presiding judge's holding that there was no basis in these dockets to find that a share-the-savings (or split-the-savings) rate would better satisfy the standards under section 7(k) of the Regional Act than the cost-based rate design actually used by BPA. (PBE at 29). The California parties argue in opposition that a share-the-savings rate would be unlawful and inappropriate. They contend in particular that the purpose of section 7(k) and the incorporated statutory standards require a cost-based rate design. (CBOE at 19-20).

The PNW parties contend that BPA's rates must be designed to achieve an equitable sharing of benefits between regions. The PNW parties rely upon language in section 6 of the Bonneville Project Act (16 U.S.C. § 832e (1982)) and section 5 of the Regional Preference Act (16 U.S.C. § 837d (1982)) as a basis for their contention that BPA's rates for nonfirm energy must result in an equitable sharing of the benefits of nonfirm energy. (PBE at 37).[18] They contend that the presiding judge failed to rule on their argument based upon the Bonneville Project Act. (*Id.*) The presiding judge ruled against the PNW parties' Regional Preference Act argument on the ground that the "equitable sharing" language in the Regional Preference Act refers to exchanges of power rather than to rates. (29 FERC at p. 65,077). The PNW parties further contend that even if BPA is not required by applicable statutes to use share-the-savings rates, the Commission should find that BPA's rates should be designed to produce an equitable sharing of benefits. (PBE at 40).

The PNW parties also agree that the presiding judge erred in not finding that a share-the-savings rate design would best satisfy the criteria of section 7(k) of the Regional Act. They further contend that the presiding judge was in error in suggesting that BPA must justify use of share-the-savings rates rather than cost-based rates. In addition, the PNW parties object to the presiding judge's characterization of share-the-savings rates as value-based rates. Finally, the PNW parties contend that the presiding judge erred in finding that the savings to the buyer of economy energy were not germane to the design of economy energy rates. According to the PNW parties, the presiding judge incorrectly found that such savings were to be measured by what a buyer would have paid to another supplier rather than what it would have cost purchasers to produce the energy themselves.

The California parties first contend in response to the PNW parties that a Commission mandate to BPA to use a share-the-savings form of rate would be unwarranted because the record is insufficiently developed and because the Commission lacks the authority to require BPA to follow a particular rate design. (CBOE at 19). The California parties next claim that a share-the-savings rate would be inconsistent with the statutory stan-

dards applicable to BPA's rates for nonfirm energy to purchase outside the PNW.

In particular, the California parties contend that share-the-savings rates would be in violation of the requirement that the rates promote widespread use of nonfirm energy at the lowest possible level consistent with sound business principles. (CBOE at 20). The California parties further contend that share-the-savings rates would not result in more production of nonfirm energy by BPA, so that it would not result in more widespread use of BPA nonfirm energy. The California parties contend that the Commission has previously rejected share-the-savings rates for BPA, citing the Commission's prior order, *Bonneville Power Administration*, 23 FERC ¶ 61,342, at pp. 61,739, 61,741. In that order the Commission made a number of comments with regard to BPA's H-6 share-the-savings rate in the course of approving the H-6 rate.

Concerning the arguments by the PNW parties that share-the-savings rates would contribute to economic efficiency, the California parties argue that the regional and public preferences governing BPA's operations and the capacity limitations of the Pacific Intertie preclude the operation of the sort of market in which share-the -savings rates lead to greater economic efficiency. (CBOE at 28).

In its brief opposing exceptions, BPA defends the presiding judge's conclusion that BPA could use a share-the-savings approach in developing rates for nonfirm energy. BPA contends that such an approach is allowable under the statutes governing BPA and that share-the-savings is the most important yardstick against which to measure the appropriateness of the NF-1 and NF-2 rate schedules. (BBOE at 73).

We find that since BPA did not propose such a share-the-savings rate for use during the locked-in NF-1 and NF-2 periods, the issue of whether BPA may use share-the-savings rates is not before the Commission in this proceeding.[19]

Concerning the arguments by PNW parties that the applicable statutes require the use of share-the-savings rates, we agree with the presiding judge (29 FERC at p. 65,077) that the "Equitable

sharing" language of section 5 of the Regional Preference Act does not require such rates to be used by BPA for nonfirm energy, because it applies to exchange agreements for power rather than rates for nonfirm energy. Concerning the arguments of the PNW parties as to the language of section 6 of the Bonneville Project Act, we agree with the California parties that the language of this section is concerned with treatment of transmission costs in BPA's regional rates rather than with rates for economy energy sold outside the PNW. As such, the language is pertinent to review of regional rates under section 7(a) of the Regional Act, rather than non-regional rates under section 7(k). It follows that the applicable statutes do not require BPA to use share-the-savings rates for nonfirm energy sales.

Under the circumstances, no more need be said in the absence of record based upon a share-the-savings rate actually proposed by BPA.

M. The presiding judge's finding as to discrimination will be vacated, and the issue is made subject to the outcome of Docket No. EF84-2011-006.

The CEC contended that BPA had engaged in unlawful discrimination against non-PNW customers by making simultaneous sales of nonfirm energy to different purchasers at different prices and by entering into contracts for the shutdown of the Trojan nuclear plant with the effect of giving a lower rate to nonfirm energy to the PNW owners of the Trojan plant. The presiding judge found that allegations of discrimination were outside the jurisdiction of the Commission under section 7(k) of the Regional Act. (29 FERC at p. 65,107.) No party took exception to the finding by the presiding judge.

However, because the Commission has made the question of the implementation criteria for BPA's nonfirm rates an issue in the hearing on BPA's NF-83 nonfirm rates filed in Docket No. EF84-2011-006,[20] and because the record in the NF-83 proceeding may shed more light the question, we shall vacate the presiding judge's finding on this issue.

N. The Commission concurs in the finding of the presiding judge concerning the issue of vagueness in the NF-1 rate schedule provisions.

The CEC and the California Utilities had challenged the NF-1 rate schedule provisions allowing BPA to charge a higher rate than the floor rate to recover the cost of thermal energy stored in BPA reservoirs. The CEC contended that the inherent uncertainty of this provision gave BPA virtually unlimited discretion, so that BPA could sell any mix of high or low cost resources to whichever customer it chose, based on no objective criteria. The California Utilities took the position that the NF-1 rate schedule allowed BPA discretion to establish such a broad range of nonfirm rates that this fluctuating ratemaking methodology permitted BPA simultaneously to charge a higher rate to customers outside the PNW and a lower rte to PNW customers. (*Id.* at pp. 65,098-99).

The presiding judge concluded that the evidence was persuasive that, notwithstanding an undesirable lack of certainty in the NF-1 rate, BPA took steps to inform its customers about its procedures for pricing energy and to adjust these procedures in response to customer comments. The presiding judge further found that there were no grounds for the California intervenors to complain that they were harmed as a group, since the average price paid by California purchasers was less than that paid by PNW purchasers and since the prices paid were below BPA's cost to provide the energy.[21] (*Id.* at p. 65,099).

No party appears to have taken direct exception to the presiding judge's conclusion. Since we have set the question of implementation criteria for hearing in the NF-83 proceeding (27 FERC at 61,467), and since we have approved BPA's approach of including basically all of its costs in the cost of nonfirm energy for the NF-2 rates, we concur in the presiding judge's ultimate determination on this question.

III. BPA's NF-1 and NF-2 rates Are Approved

The presiding judge found that BPA had erred in purposely setting the NF-1 and NF-2 rates at levels which were not high

enough to recover the costs BPA thought properly attributable to them. In addition, he found that BPA had failed to design its rates in such a fashion that it could recover an average revenue per unit of energy equal to the average cost per unit of energy. (*Id.* at p. 65,121). The presiding judge recognized that BPA had to take account of the possibility that purchasers would refuse to buy nonfirm energy if the price were too high compared to the alternatives available to them. He found, however, that BPA could have charged an average rate equal to its average cost per kWh and still sold the same actual amount of nonfirm energy to California purchasers. (*Id.* 65,122-13).

The presiding judge further found that there "was no excuse for BPA not designing its nonfirm rates so as to recover the costs fairly allocated to nonfirm energy from nonfirm energy users." (*Id.* at p. 65,113). He concluded that "[t]his failure was a violation of the statutory standard respecting 'the lowest possible rates to consumers consistent with sound business principles.' " (*Id.*) Subsequently, the judge noted that "[t]o the extent that BPA's projected revenue from nonfirm customers was in error and caused the firm rates to be set higher than would otherwise have been the case, the firm customers suffered a significant wrong." (*Id.* at p. 65,121). The apparent basis for the judge's finding that the rates violated the standard was therefore that because the rates did not result in the recovery of the costs of nonfirm energy from purchasers of nonfirm energy, the purchasers of firm energy paid higher rates than they should have.

Trial staff points out that BPA did not know at the time that it was developing its rates of marketing the nonfirm energy what the costs to the California purchasers were for energy from BPA competitors. (SBE at 41). The California parties do not oppose the staff argument, contending only that the trial staff is in error in suggesting that the NF-1 or NF-2 rates were "below properly allocated costs for nonregional nonfirm energy (CBOE at 5). The PNW parties contend that the record shows that "BPA had extensive data, at the time of making the NF rates, of the prices California Utilities were willing to pay for nonfirm energy." (PBOE at 14). The PNW parties argue further that "lack of knowledge does not excuse BPA's . . . establishing the cost of

production as an absolute price ceiling, and marketing nonfirm energy only at or below cost, never above." (PBOE at 14-15). The PNW parties cite to various parts of the record of the proceedings before BPA in support of the proposition that BPA knew in advance what the likely costs for alternative energy to the California purchasers would be. (PBOE at 109).

However, the portions of the record cited by the PNW parties do not support the proposition that BPA could know with reasonable certainty at the time that energy was to be marketed the maximum price that California purchasers would pay for the amount of nonfirm energy that BPA might have available to sell at that time.[22] The cited material merely shows that at times California purchasers might be willing to pay higher prices for energy. The cited material does not show that BPA could know when such occasions would occur or how much higher prices California purchasers would be willing to pay.

The cited material merely demonstrates that BPA knew what California incremental costs might be over a period of time, not what they actually were at any given point in time. The Commission trial staff is correct that the presiding judge was in error in concluding that BPA knew how much alternative energy sources at given points in time would cost. (SBE at 43). BPA had to be concerned with establishing a rate that would allow it to market energy under conditions of uncertainty at times when the alternative to selling the energy was waste through spill. (Ex. No. 3 at 10; Ex. No. 4 at 21-22). BPA's witness asserted that the floor or spill rates were necessary to allow BPA to sell energy below cost when this was required by competitive market conditions. (*Id.*)

We have determined that BPA's rates are consistent with the statutory criteria and that they should therefore be approved. As discussed previously, the rates were based upon BPA's costs properly attributable to the production of nonfirm energy, so that the various contentions by the California parties that the rates were too high must be rejected. At the same time, it was reasonable for BPA to provide for below cost rates to use when the demand for energy relative to BPA's supply may be such that BPA could not market or store all the energy that it had available. BPA operates its system to maximize the production of useful

energy. It stores energy in its reservoirs as part of this maximization process. This stored energy is a wasting asset. If the market for energy does not ultimately turn out to be what BPA had expected at the time it was storing energy in its reservoirs, it may be necessary for BPA to lower its price below what it cost to produce the stored energy if its is to sell the energy and recover some revenues from the energy rather than to have it be wasted through spill.

We are not prepared to say that BPA was obligated to provide for rates above costs in order to assure that sales at below-cost rates would be offset. We believe that it would be unreasonable to find such a requirement, in light of the latitude in the statutory requirement that the rates be as low as possible consistent with sound business principles. BPA's testimony (*Id.*) shows its concern with setting its rates at levels that would allow it to try to avoid waste through spill, while at the same time trying to recover as much of its costs as possible. Under the circumstances, in which BPA had knowledge as to its own overall costs but much less knowledge as to the value of the nonfirm energy to BPA's customers, we find that it was reasonable for BPA to adopt the approach that it used with the NF-1 and NF-2 rate schedules of setting maximum rates for nonfirm energy on the basis of BPA's determination of the cost of nonfirm energy and providing for below-cost rates in the event that they were necessary to avoid the waste of onfirm energy.

The Commission orders:

(A) The initial decision issued in Docket Nos. EF81-2011-003 and EF82-2011-003 on November 27, 1984, is affirmed and adopted except to the extent modified or reversed herein. Exceptions to the initial decision not granted in this Opinion are hereby denied.

(B) BPA's NF-1 and NF-2 rate schedules for extraregional sales of nonfirm energy for the locked-in period are hereby approved on a final basis.

(C) Docket Nos. EF81-2011-003 and EF82-2011-003 are hereby terminated. Commissioner Stalon *concurred* with a separate statement to be issued later.

Footnotes

[1] Under the Pacific Northwest Electric Power Planning and Conservation Act of 1980 (Regional Act, 16 U.S.C. §§ 839 to 839h (1982), the PNW region is essentially defined as the States of Oregon, Washington, Idaho, and that portion of Montana to the west of the Contental Divide, plus the portions of Utah, Nevada, and Wyoming that are part of the Columbia River drainage basin. Purchasers of energy within the United States but outside the PNW are referred to as extraregional customers.

[2] 16 U.S.C. § 832 (1982)

[3] 16 U.S.C. § 835 (1982)

[4] 16 U.S.C. § 838 (1982)

[5] Docket Nos. EF81-2011-000 and EF82-2011-001 were subsequently redesignated as EF81-2011-003 and EF82-2011-003, respectively.

[6] The NF-1 rate schedule was applicable to the period July 1, 1981 to September 30, 1982, and the NF-2 rate schedule was applicable to the period October 1, 1982 to October 31, 1983. The NF-2 rate schedule was subsequently superseded by an NF-83 rate schedule on November 1, 1983, so that the rates at issue here are for a locked-in period. The provisions of the NF-1 and NF-2 rate schedules are summarized in the initial decision. (29 FERC at p. 65,074).

[7] Parties filing briefs on exceptions were: the California Public Utilities Commission (CPUC); the California Energy Commission (CEC); the Commission trial staff; various California utilities in a joint brief—Southern California Edison Company, San Diego Gas & Electric Company, Pacific Gas & Electric Co., Los Angeles Department of Water & Power along with the Cities of Burbank, Glendale and Pasadena (California Utilities), and various PNW parties in a joint brief —the Direct Service Industries, the Association of Public Agency Customers, the Public Generating Pool, the Public Power Council, and Portland General Electric Company (PNW parties). Briefs opposing exceptions were filed by the California Utilities, the PNW parties, the Commission trial staff, and BPA.

Subsequent to the filing of briefs, various motions to strike and responses were filed by various parties. Because we do not rely upon the material at issue in any of the motions to strike, we shall treat them as moot.

[8] BPA had separate floor rates for peak and off-peak periods. (Ex. No. 3 at 10).

[9] The presiding judge in the initial decision and the parties in their briefs have spoken on occasion in terms of allocation of costs to the production of nonfirm energy. This usage is not harmful so long as it is understood, as the presiding judge reorganized (29 FERC at p. 65,083), that in fact what BPA did in developing its firm cost-of-service was to allocate essentially all costs for its system to the production of firm energy. BPA credited the revenues that it expected from sales of nonfirm energy against the costs that it allocated to its firm energy purchasers. (Ex. No. 3 at 14-15). It should be recognized that there is a distinction between allocating capacity costs for purposes of developing a firm requirements cost-of-service and using the resultant per unit capacity cost as an upper limit in cost determination for coordination service. Florida Power & Light Corporation, 33 FERC ¶ 61,116, at p. 61,248 (1985). In their briefs, the various parties have referred to BPA's "spreading" of costs as an assignment of costs on an "unweighted, proportional basis" for the purpose of developing the cost of nonfirm energy. This phrase refers to using the total forecast quantity of energy, firm and nonfirm, as the divisor in determining the nonfirm energy rate. We will follow this usage in our discussion.

[10] As we shall explain subsequently, the rationale underlying the approval of the NF-2 rates logically requires the conclusion that the NF-1 rates, viewed on the same general cost-of-service basis, were not excessive, and the rationale for finding that the NF-2 rates were not unreasonably low also applies to the NF-1 rates.

[11] although BPA is restricted by the Pacific Northwest Consumer Power Preference Act (16 U.S.C. §§ 837-837h (1982)) (Regional Preference Act) from selling any energy other than surplus energy outside the PNW region, this statutory marketing poolicy does not affect the underlying characer of BPA's production system. As noted, BPA's system is energy-constrained and operated to maximize the production of useful energy. This is a result of the character of BPA's production capacity and of the requirements of the PNW Coordination Agreement to which BPA is a party. (Ex. No. 14 at 6.9 Tr. Vol. 17/pp. 2688-89). The fact that BPA is precluded by the PNW preference statute from offering energy to extraregional purchasers except with a right to curtail delivery upon no more than 60 days' notice (16 U.S.C. § 837b(a) (1982)) does not change the costs to BPA of operating its system to maximize the production of useful energy,

[12] The statutory criteria for BPA's rates for extraregional sales of nonfirm energy are not identical to the criteria of the Federal Power Act. Nevertheless, given that BPA has chosen to propose cost-based rates, Commission decisions under the Federal Power Act may serve as useful guides in addressing the question of how properly to develop costs for nonfirm energy rate determination.

[13] In general, nonfirm customers do not share responsibility for capacity costs under a peak responsibility demand allocation method. *Delmarva Power & Light Co.* Opinion No. 185, 24 FERC ¶ 61,199, at p. 61,462. However, in several opinions, the Commission has explained that exclusion of off-system sales for purposes of setting requirements rates does no recover a portion of capacity costs. *Id., Wisconsin Public Service Corporation.* 25 FERC ¶ 61,101, at p. 61,325. In Wisconsin Public Service Corporation, the Commission stated.

> In several prior cases we have recognized that equitable considerations mandate that the interruptible customers make a contribution to the system's fixed costs . . . Although the wholesale interruptible loads cannot, by definition, contribute to the need for capacity additions, they nevertheless benefit from existing capacity and should pay a portion of its costs.

In opposition to the judge's decision, Algoma cites Minnesota Power & Light Company (MP&L) and Kentucky Utilities Company (KU). These cases are distinguishable. Both of them involved the question of whether the interruptible load should be included in allocating demand costs under the peak demand responsibility method and both concluded that since the company's right to interrupt allowed it to control peak demands by interrupting customers, these customers' loads should be excluded from the demand allocation fromula used to set rates for requirements customers . . . The MP&L and KU decisions did not hold that it is improper to place a per kW charge on interruptible sevice. 25 FERC at p. 61,325.

See also, Florida Power & Light Company. 33 FERC ¶ 61,116, at pp. ¶ 61,247-48 (1985).

[14] Supra, note 11.

[15] The concept of "shaping the availability of energy" refers to the point that because BPA has storage capacity in which it can retain some of the flow of the hydro resources for later release, it can change the availability of the hydro energy (i.e., "shape" 11) from when it would naturally be available. (Ex. No. 2 at 17).

[16] "Generally, the costs will be shared during this period with any sales of excess firm, IOU load growth, new large industrial loads of preference customers, and contract demand sales for special purposes." S. Rep. No. 96-272, 96th Cong., 59 (1979). The PNW parties contend that the report was written a year before section 7, dealing with nonfirm rates, was added to the statute, and that the section of the report in which the quoted language appears deals exclusively with firm power rates. We think the sentence provides some, if not conclusive, evidence that nonfirm customers were not intended to fund the exchange program.

[17] The price in a share-the-savings transaction is a function of the difference between the seller's incremental cost and the buyer's decremental cost. A purchaser with a relatively low decremental cost will pay a lower price than a purchaser with a relative high decremental cost. The purchaser with a greater potential savings from purchasing energy will pay a higher price for the same energy.

[18] The pertinent language in section 6 of the Bonneville Project Act provides that BPA's rate schedules ". . . may provide for uniform rates or rates uniform throughout presented transmission areas in order to extend the benefits of an integrated transmission system and encourage the equitable distribution of the electrical energy developed at the Bonneville project." Section 5 of the Regional Preference Act concerns exchange contracts between BPA and utilities outside the PNW in which each party is both a provider and a receiver of energy. The section provides that "[a]ll benefits from such exchanges, including resulting increases of firm power, shall be shared equitably by the areas involved, having regard to the secondary energy and other contributions made by each."

[19] The presiding judge held that BPA is not required by the applicable statutes to set rates on a cost-of-service basis. (29 FERC ¶ 63,039, at p. 65,077). The California parties have execpted to this finding. Because the proceeding has been concerned with what cost determination for BPA's cost-based rates for nonfirm energy, the question of whether BPA is required to base its rates only upon costs is not before the Commission at this point.

[20] 27 FERC ¶61,251, at p. 61,476 (1984), 28 FERC ¶ 61,078, at p. 61,147 (1984). The Commission noted in its first hearing order on the NF-83 rates that the question of whether BPA had made power available to extraregional customers on fair and reasonable terms and conditions was part of the inquiry in reviewing extraregional rates. In the

subsequent order on rehearing, the Commission agreed with BPA that reviews of specific instances of implementation was outside the Commission's jurisdiction over BPA, but that the Commission could "review [the implementation criteria's] overall effect for compliance with the applicable statutes." 28 FERC at p. 61,147.

[21] We note that the average price paid is a function of different amounts of energy marketed at rates starting with the floor rate and varying upward according to the amount of thermal energy "stored" in BPA reservoirs (Ex. No. 3J at 3). Given that BPA markets nonfirm energy in accord with the dictates of Regional Preference Act, there is no reason why the average prices for sales in the PNW and outside the PNW need to be equal.

[22] Hearing before Administrator on 1981 BPA rates at Tr. Vol. 17/pp. 3635, 3693. No. 1 (Designated 1982 BPA Record) at pp. 4063, 15499-500.

Appendix D

[¶ 61,033]

United States Department of Energy—Bonneville Power Administration, Docket Nos. EF81-2011-005, EF81-2011-006, EF82-2011-005, and EF82-2011-006

Opinion No. 250-A; Order Denying Requests for Rehearing and Request for Oral Argument

(Issued April 21, 1987)

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon, Charles A. Trabandt and C. M. Naeve.

[Note: Opinion No. 250, issued September 24, 1986, appears at 36 FERC ¶ 61,335.]

[Opinion No. 250-A Text]

On October 24, 1986, the California Parties[1] and the Northwest Parties[2] each filed requests for rehearing of the Commission's September 24, 1986 Opinion approving Bonneville Power Administration's (BPA) NF-1 and NF-2 rate schedules, governing BPA's nonregional, nonfirm rates for the period July 1, 1981 through October 31, 1983. In Opinion No. 250, 36 FERC ¶ 61,335 (1986), the Commission decided what costs BPA may incorporate in these rates, given BPA's decision to submit cost-related rates for Commission review and approval.[3] In that Opinion, we concluded that BPA may include all of the production and transmission costs in its cost determination for nonfirm energy, as proposed by BPA in this proceeding.

In particular, we approved BPA's inclusion in its cost determination of the following costs on an unweighted, proportional basis: (1) BPA's transmission system; (2) BPA's capacity under construction (the Washington Public Power Supply System (WPPSS) nuclear plants); (3) BPA's conservation program; (4) its fish and wildlife protection program; and (5) concerning the NF-2 costs only, its deferred interest owed to the Federal Treasury. We reversed the initial decision insofar as it limited the

includable costs of nuclear plants under construction and of conservation programs to the costs associated with 3,300 MW of capacity. We also reversed the presiding judge's ruling that subsidy costs of a residential exchange program should be included in BPA's cost determination, because, in our view, Congress intended these costs to be borne exclusively by direct-service industrial (DSI) customers and other customers in the Northwest region. Moreover, we reversed the initial decision insofar as it disapproved the rates as being too low. We concurred with the judge that it is unnecessary to consider whether a share-the-savings rate design would better satisfy the review standard of section 7(k) of the Pacific Northwest Electric Power Planning and Conservation Act (Regional Act)[4] because BPA did not submit for Commission approval rates designed on a share-the-savings basis. Accordingly, we reviewed and approved BPA's NF-1 and NF-2 rate schedules as proposed by BPA.[5]

In their request for rehearing of Opinion No. 250, the California Parties essentially argue that the Commission erroneously applied the review standard of section 7(a)(2) of the Regional Act,[6] rather than the section 7(k) standard, when it approved rates that were based on BPA's total system costs.[7] The California Parties also argue that BPA's nonregional, nonfirm rates may not include costs for the conservation and fish and wildlife programs mandated by the Regional Act, or costs for the construction of the uncompleted WPPSS nuclear plants, because none of these costs are associated with the production of energy.[8] These parties also assert that section 7(g) of the Regional Act[9] precludes BPA from allocating to nonregional, nonfirm rates the costs of its conservation and fish and wildlife programs.[10] The California Parties also request an opportunity to present oral argument to the Commission. They assert that oral argument would provide the Commission with an opportunity to resolve directly any concerns and questions it has in connection with this proceeding.

In their request for rehearing, the Northwest Parties complain that Opinion No. 250 fails to address the merits of their argument that BPA should have been required to adopt a share-the-savings rate.[11] The Northwest Parties also argue that the rates, as submitted for Commission review and approval, do not satisfy the

section 7(k) standard because they fail to allow BPA to take advantage of market conditions that would enable it to charge its nonregional customers above-cost rates for nonfirm energy to offset instances in which BPA must sell nonfirm energy below cost to avoid wasting energy through spill.[12] These parties also contend that the Commission misconstrued congressional intent in concluding that the subsidy costs of BPA's residential exchange program were not allocable to nonregional, nonfirm purchasers.[13]

On November 24, 1986, the Commission granted rehearing for limited purpose of further consideration of the parties' requests for rehearing. For the reasons discussed below, we shall deny both rehearing requests.

Discussion

A. The California Parties' Request

We disagree with the California Parties' contention that by approving BPA's total system cost approach, the Commission in effect applied section 7(a)(2) review criteria instead of the section 7(k) standard of review. Nothing in section 7(k) of the Regional Act precludes BPA from proposing, or the Commission from approving pursuant to section 7(k), a rate design that might independently satisfy the review criteria of section 7(a)(2). We continue to believe that BPA's use of the total system cost approach in determining its section 7(k) rates was reasonable given the unusual character of BPA's system: BPA produces both firm and nonfirm energy from hydroelectric resources with substantial storage capacity and from thermal resources, and its system is planned and operated for the maximum production of energy.

BPA energy is denominated as firm or nonfirm only at the time of sale. Where, as here, BPA is unable to trace that energy from particular generation resources to particular sales, it cannot reasonably identify particular incremental costs associated with nonfirm sales. Use a rate design with downward flexibility based on the allocation of BPA's total system costs spread over all energy expected to be produced during the rate period reasonably assures BPA that its rates are held low enough to attract sales and promote widespread use of BPA power, yet high enough to

recover its costs when market conditions permit, as section 7(k) contemplates. Thus, there is no merit in the California Parties' argument that the Commission effectively substituted the section 7(a)(2) standard of review for the section 7(k) standard in approving BPA's NF-1 and NF-2 rates.

The California Parties' arguments[14] that BPA's nonfirm rates may not include the costs for BPA's conservation programs, fish and wildlife programs, and the uncompleted WPPSS nuclear plants, because these costs are not associated with the production of energy, were considered and rejected in Opinion No. 250. It was reasonable for BPA to apportion to nonregional, nonfirm energy not only its production-related operating costs, but also, to the extent not directly assignable to other classes of purchasers of BPA power, the ancillary costs of doing business as a power producer, such as the costs of the statutorily mandated conservation and fish and wildlife programs, and the uncompleted nuclear plants. The California Parties' argument, if carried to its logical conclusion, would preclude allocating these costs to *any* energy sales, not just nonfirm sales, and would effectively shift to the U.S. taxpayer the burden of these costs, which is prohibited by the Regional Act. Therefore, this argument does not warrant rehearing.

The California Parties also argue that the Commission erred in approving BPA's inclusion in nonfirm rates of the costs of its conservation and fish and wildlife programs because the provisions of section 7(g) of the Regional Act, requiring BPA to "equitably allocate to power rates" all costs and benefits not otherwise allocated by other provisions of law, were intended only to apply to firm customers of BPA.[15] In support, they cite legislative history of section 7(g), S. Rep. No. 272, 96th Cong., 1st Sess. 60 (1979), which states that general costs under section 7(g) of the proposed Regional Act, including conservation, would be applied as an overall rate adjustment "to all firm power sales under any rate." We have carefully considered the legislative history of the Regional Act, and remain convinced that Congress intended the costs for BPA's conservation and fish and wildlife programs to be borne by all BPA power purchasers, not just firm

power customers.[16] Accordingly, the California Parties' rehearing request shall be denied.

Concerning the California Parties' request for oral argument, it does not appear that such a proceeding would produce any new factual information which would assist the Commission in determining whether to grant the rehearing. The request will therefore be denied.

B. The Northwest Parties' Request

The Northwest Parties argue on rehearing that BPA should have been required to adopt a share-the-savings rate for its nonregional, nonfirm customers because, they allege, that rate design would be more likely to recover BPA's cost of service, or as much of that cost as market conditions would allow, than the cost-based rates proposed by BPA.[17] Although these parties concede that "section 7(k)'s broad rate design standards [do not] compel the adoption of any single rate form,"[18] they argue in effect that the Commission must, when confronted with alternative rate designs proposed by intervenors that would also satisfy the section 7(k) standard, approve only the rate design that best satisfies that standard. The Northwest Parties contend that the Commission never ruled on their argument that BPA's use of a share-the-savings rate design would better satisy the section 7(k) standard than the cost-based design adopted by BPA for its nonregional, nonfirm customers.[19]

As we stated in Opinion No. 250, it is unnecessary in this proceeding to determine whether a share-the-savings rate design would be preferable in terms of meeting the section 7(k) standard because there is no statutory requirement for use of a share-the-savings rate, and because BPA did not submit that form of rate design to the Commission for confirmation and approval.[20] Thus, once the Commission finds that a nonregional, nonfirm rate design submitted by BPA meets the section 7(k) standard as we did in Opinion No. 250 with respect to BPA's proposed cost-of-service rate design, our inquiry is ended and BPA's proposed rates are entitled to Commission approval. Contrary to the Northwest Parties' suggestion, nothing in section 7(k) of the Regional Act or in any other statute requires that we consider *de novo* alternative

rate designs not proposed by BPA to determine whether they might better satsfy the section 7(k) standard. Rather, our role is limited to affording the parties appellate review of BPA's proposed nonregional, nonfirm rates for overall compliance with the section 7(k) standard based on the record developed by BPA in its own administrative rate proceeding conducted pursuant to section 7(i) of the Regional Act.[21] Accordingly, the Northwest Parties' argument that a share-the-savings rate design would better satisfy section 7(k) than the cost-based rates proposed by BPA does not warrant rehearing.

The Northwest Parties also claim that BPA's cost-based rates do not satisfy the section 7(k) standard at all because, they argue, BPA's nonregional, nonfirm rate design is neither "consistent with sound business principles" nor sufficient to "recover BPA's cost of service and protect the interest of the United States in amortizing BPA's debt to the U.S. treasury."[22] These parties complain that the rates were purposefully designed to be "downwardly flexible," enabling BPA to provide below-cost rates during times of excess supply, but precluding BPA from recovering more than its costs from particular sales when market conditions would otherwise permit it to do so.[23]

As we stated in Opinion No. 250, the section 7(k) standard affords BPA significant latitude in light of the requirement that rates be as low as possible consistent with sound business principles.[24] It must be borne in mind that BPA stores energy as part of a system that maximizes the production of energy. In designing its rates for this system, BPA was faced with the twin difficulties of predicting with reasonable certainty the maximum price that California purchasers would pay for nonfirm energy at any given point in time, while avoiding the waste of energy through spill. Accordingly, nothing alters our view that BPA's cost-based rates that enabled BPA not only to recover its cost in the market during normal supply conditions but also to recover less than its costs as an alternative to wasting energy, were reasonably calculated to: (1) be as low as possible consistent with sound business principles; (2) encourage the most widespread use of BPA power; (3) recover the costs of generating and transmitting such power; and

(4) protect the Federal investment. It therefore follows that this argument must be rejected.

The Northwest Parties also contend that the Commission misconstrued legislative intent in concluding that Congress did not intend the costs of the residential exchange program established by section 5(c) of the Regional Act[25] to be allocated to nonregional purchasers of nonfirm energy.[26] These parties argue that the energy acquired and resold pursuant to the residential exchange program constitutes "purchased power" that is always included as a cost in economy energy rates when the purchaser's economy energy sales occur simultaneously with the power purchases. BPA is not, however, purchasing residential exchange energy on an economy energy basis in that the section 5(c) exchange energy is priced on the basis of the average system cost of the purchaser. Thus, the costs of the energy to BPA are established by the provisions of the Act and are not a result of the purchase and sale of "economy energy." Our review of the legislative history of section 5(c) satisfies us that Congress intended to confine the allocation of the costs of the residential exchange program to BPA's DSI customers and other Northwest customers.[27] Accordingly, the Northwest Parties' rehearing request shall be denied.

The Commission orders:

(A) The requests for rehearing filed by the California Parties and the Northwest Parties are denied.

(B) The California Parties' request for oral argument is hereby denied.

(C) Subdocket numbers 005 and 006 of Docket Nos. EF81-2011 and EF82-2011 are hereby terminated.

Footnotes

[1] The California Parties include the Public Utilities Commission of the State of California, the California Energy Resources Conservation and Development Commission, the Southern California Edison Company, the Pacific Gas and Electric Company, the San Diego Gas & Electric Company, the Department of Water and Power of the City of Los Angeles, the Public Service Department of the City of Burbank, the Public Service Department of the City of Glendale, and the Water and Power Department of the City of Pasadena.

[2] The Northwest Parties include the Public Power Council, the Public Generating Pool, the Association of Public Agency Customers, the Portland General Electric Company, and the Direct Service Industries.

[3] Opinion No. 250 was concerned with what types of costs BPA may include in its nonregional, nonfirm rates in light of its decision to adopt a cost-based rate design, and did not address whether BPA is required to base rates only upon its costs. *See* 36 FERC at p. 61,820 n.19.

[4] 16 U.S.C. § 839e(k) (1982). As we stated in Opinion No. 250, 36 FERC at p. 61,798, section 7(k) provides that the Commission shall review rates filed under that subsection for conformance with certain statutes, read together, require BPA to design rates:

1. having regard to the recovery of the cost of generation and transmission of such electric energy;

2. so as to encourage the most widespread use of BPA power;

3. to provide the lowest possible rates to consumers consistent with sound business principles; and

4. in a manner which protects the interests of the United States in amortizing its investments in the projects within a reasonable period.

See also Central Lincoln Peoples' District v. Johnson, 735 F.2d 1101, 1114 (9th Cir. 1984) (Central Lincoln).

[5] 36 FERC at p. 61,818.

[6] 16 U.S.C. § 839e(a)(2) (1982).

[7] California Parties' request for rehearing (CPRR) at 4-6.

[8] CPRR at 9-10.

[9] 16 U.S.C. § 839e(g) (1982).

[10] CPRR at 16-20.

[11] Northwest Parties' request for rehearing (NPRR) at 1-2.

[12] NPRR at 4-9.

[13] NPRR at 14.

[14] CPRR AT 9-16.

[15] CPRR AT 16-20.

[16] *Cf. Central Lincoln,* 735 F.2d at 1124 (BPA's cost of allocation of fish and wildlife measures in all BPA customers found equitable under section 7(g) of the Regional Act because all BPA users "benefit in some fashion from hydro resources").

[17] NPRR at 9-12.

[18] *Id.* at 9 n.10.

[19] *Id.* at 2, 10.

[20] 36 FERC at p. 61,816.

[21] 16 U.S.C. § § 839e(i) (1982). *See* Southern California Edison Co. v. F.E.R.C., 770 F.2d 779, 784 n.3, 785-86 (9th Cir. 1985).

[22] NPRR at 1-2.

[23] *Id.* at 5.

[24] 36 FERC at p. 61,818.

[25] 16 U.S.C. § 839e(c) (1982).

[26] NPRR at 14.

[27] *See, e.g.,* H.R. Rep. No. 976, 96th Cong., 2d Sess. (Pt. 1) 29, 61 (1989); H.R. Rep. No. 976, 96th Cong., 2d Sess. (Pt. 2) 35 (1980); S. Rep. No. 272, 96th Cong., 1st Sess. 10, 15, 59 (1979).

No. 90-506

IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

CALIFORNIA PUBLIC UTILITIES COMMISSION,
Petitioner,

v.

BONNEVILLE POWER ADMINISTRATION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF OF RESPONDENT CALIFORNIA ENERGY COMMISSION IN SUPPORT OF PETITIONER

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QUESTIONS PRESENTED

1. Whether Section 7(k) of the Pacific Northwest Electric Power Planning and Conservation Act ("the Act") authorizes the Federal Energy Regulatory Commission ("FERC") to hold an evidentiary hearing in reviewing rates set by the Bonneville Power Administration ("BPA").

2. Whether the Act authorizes BPA to charge California purchasers of nonfirm electricity the fully allocated costs of BPA's system, when those purchasers do not enjoy benefits of the system proportional to those enjoyed by Northwest firm power customers.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-505

CALIFORNIA PUBLIC UTILITIES COMMISSION,
Petitioner,

v.

BONNEVILLE POWER ADMINISTRATION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF OF RESPONDENT CALIFORNIA ENERGY COMMISSION IN SUPPORT OF PETITIONER

Although it has elected not to file its own petition for certiorari in this particular case, respondent California Energy Commission ("CEC") supports the petition filed by the California Public Utilities Commission ("Petitioner").

The decision below is one of a series of decisions by the Ninth Circuit upholding actions of the Bonneville Power Administration ("BPA") that disfavor California energy consumers and favor Northwest power inter-

ests in violation of statutory requirements. In the decision below, the Ninth Circuit has held that BPA's rates to California utilities need not be "fair and reasonable," as required by 16 U.S.C. §§ 829e(k) & 825s, and that BPA may therefore charge California utilities a proportional share of all of its costs even though it provides a substantially lower grade of service to those utilities than it provides to its Northwest firm power customers. Even more important, the decision below has vitiated the procedures for special review of such rates by the Federal Energy Regulatory Commission ("FERC")—procedures prescribed by Congress in an effort to protect California against BPA's recognized regional bias. In another decision, the same panel of the Ninth Circuit has also held that BPA is free to engage in undue discrimination against California consumers because, in the panel's view, no statute expressly prohibits such discrimination. *Southern California Edison Co.* v. *Jura*, 909 F.2d 339, 343-44 (9th Cir. 1990). And in a third decision, the Ninth Circuit has upheld another BPA order which grants preferential treatment to Northwest utilities in the provision of transmission services and restricts competition among those utilities, thereby further inflating the wholesale electricity prices paid by California utilities. *California Energy Comm'n* v. *BPA*, 909 F.2d 1298 (9th Cir. 1990).

In sum, the Ninth Circuit is systematically eliminating most or all of the protections California energy consumers had received from Congress when it provided for the development of the Bonneville power system. Sooner or later this Court must act to correct this imbalance. To assist the Court in deciding whether this is the appropriate time for this Court to act, the CEC will initially sketch the history of the BPA and explain the bases for the CEC's claim that the BPA is discriminating regionally. The CEC will then discuss the two issues presented in this specific case and their importance to the CEC. The Court certainly could use this case as a

vehicle to begin the process of correcting the errors of the Ninth Circuit, but at a minimum, it must act soon to restore the protections to which California consumers are plainly entitled under the relevant statutes.

1. The BPA was created to market electrical power generated by various taxpayer-funded and federally-owned dams on the Columbia River. See 16 U.S.C. §§ 832 *et seq.* It acquired the ability to sell power to California in 1969 with the completion of the Pacific Intertie ("Intertie"), a large transmission facility that links the Pacific Northwest and Canadian power markets with the California power market. The Intertie is used, not only to transmit BPA power, but also to transmit power produced by public and private Northwest and Canadian utilities to California. BPA owns and operates almost all of the northern end of the Intertie, which gives it effective control over virtually all transmission of electricity—generated by itself or by others—from the Pacific Northwest to California. Like the dams from which the BPA obtains its power, the portion of the Intertie owned by BPA was financed by federal taxpayer dollars. The southern portion was paid for by California utilities and their ratepayers.

Prior to the authorization and construction of the Intertie, Northwest interests objected to it because they feared it would enable California municipal utilities to obtain priority rights to inexpensive BPA power under the statutory preference enjoyed by publicly-owned utilities. See, *e.g.*, 16 U.S.C. § 832c. This political problem was resolved by a compromise measure, enacted as part of the Pacific Northwest Electric Power Planning and Conservation Act ("Pacific Northwest Act"), which mandated a limited "regional preference" in favor of the Northwest. That measure restricted the sale of federal energy outside the Northwest to "surplus energy," *i.e.*, electricity for which BPA had no market in the Northwest. 16 U.S.C. §§ 837c, 837a. This compromise pro-

tected the Northwest's first call on BPA power while allowing BPA to generate additional revenues by selling power to California that otherwise would be wasted. See H.R. Rep. No. 590, 88th Cong., 2d Sess., *reprinted in* 1964 U.S. Code Cong. & Admin. News 3342, 3343-44.

In the years since this compromise was enacted, however, BPA has gradually transmuted this limited regional preference in the *purchase* of BPA power into a blanket authorization—indeed, a mandate—to disfavor California and favor the Northwest in virtually every other respect as well. The BPA, moreover, uses the additional revenues it gains from this discrimination to reduce electricity charges in the Northwest, rather than remitting those additional revenues to the federal Treasury. See Opinion 250, 36 FERC ¶ 61,335 at 61,819 n.9 (1986). The net result is a large and unwarranted diversion of wealth from California to Northwest consumers and utilities.

The most serious example of the BPA's unfair treatment of California consumers is a BPA policy that is not yet before this Court: BPA's policy for allocating excess transmission capacity on the Intertie—*i.e.*, capacity in excess of that needed to transmit federal power and power obtained under a federal treaty with Canada. In 1974, Congress directed BPA to make excess Intertie capacity available to "*all* utilities" on a "fair and nondiscriminatory" basis. 16 U.S.C. § 838d (emphasis added). For the next ten years, BPA gave this provision its plain, common-sense interpretation: Except in unusual circumstances, the BPA made excess Intertie capacity available to all utilities from whatever region on a competitive, first-come-first-served basis. The result was that Northwest utilities were forced to compete with each other and with Canadian utilities in selling much of their excess power to California.

In 1984, however, the BPA adopted a new, interim Intertie Access Policy ("Interim Policy") designed to

protect Northwest utilities from competition among themselves and with Canadian utilities. Under that policy, the BPA granted Northwest utilities the right to transmit all of their own surplus energy (plus any power they can purchase from other utilities) on the Intertie before Canadian and California utilities could have any direct access to that facility. In most circumstances, moreover, the BPA also allocated access *among* the Northwest utilities so that they could not compete with one another. As a result of this policy, the Intertie has become an instrument for the economic exploitation of California utilities and their customers—the very parties who had constructed and paid for the southern portion of the Intertie.[1]

The BPA recently replaced its Interim Policy with a virtually identical Long Term Intertie Access Policy that has just recently been upheld by the court of appeals.[2] Like its predecessor, the new policy is a plain and unwarranted violation of the BPA's duty to allocate excess Intertie capacity on a "fair and nondiscriminatory" basis. See *supra* note 1.

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[1] Relying heavily upon the fact that the BPA's policy had not yet become permanent, the court of appeals denied petitions for review of the Interim Policy. *Department of Water and Power of Los Angeles* v. *BPA*, 759 F.2d 684, 689 (9th Cir. 1985); *California Energy Resources and Dev. Comm'n* v. *BPA*, 831 F.2d 1467, 1478-79 (9th Cir. 1987), *cert. denied*, 109 S. Ct. 58 (1988). Judge Norris dissented. He observed that the BPA's allocation policy "creates a cartel for the Northwest utility companies in the sale of power to the Southwest." 831 F.2d at 1479. According to Judge Norris, "The anticompetitive, pro-Northwest utility slant of the pro rata intertie access plan seems plainly incompatible with the statutory language requiring that the BPA be 'fair and nondiscriminatory' in its treatment of *all* utilities." Id. (emphasis in original).

[2] On July 26, 1990, a panel of the Ninth Circuit issued a decision approving this permanent intertie policy. *California Energy Comm'n* v. *BPA*, 909 F.2d 1298 (9th Cir. 1990). Rehearing was denied on October 5, 1990. CEC anticipates that it will seek review of that decision in this Court.

2. The rate order approved by the decision below is yet another example of the BPA's unauthorized interregional discrimination. BPA provides two types of electric service. "Firm" power is power that BPA is obligated to provide. It is available upon demand, without interruption, and is sold primarily to Northwest utilities. "Nonfirm" power, by contrast, is power that BPA is not obligated to sell, and which it can therefore interrupt at any time. For that reason, nonfirm power is a far lower quality of service than firm power. BPA sells primarily nonfirm power to California.

The amount of generating capacity that any electric utility—including the BPA—must maintain depends only upon the amount of firm power it is obligated to sell to its customers. Thus, under standard "cost-causation" principles of ratemaking, firm customers are typically charged a rate that reflects the full capital costs of the utility's generating capacity.[3] Nonfirm customers, on the other hand, are charged a lower rate to reflect the fact that their usage does not obligate the utility to maintain any particular level of generating capacity.

The BPA rate order at issue here represents a marked departure from these principles because it requires nonfirm customers in California to pay rates that reflect the entire fully-allocated costs (including capital costs) incurred by the BPA in servicing all of its customers.[4] By forcing California consumers to bear costs which they did not cause to be incurred, the BPA's rate schedule

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[3] See, *e.g.*, *Wisconsin Public Serv. Corp.*, 25 FERC ¶ 61,101 at 61,325 (1983); *Minnesota Power & Light Co.*, 11 FERC ¶ 61,312 at 61,648 (1980); *Municipal Light Bds.* v. *Boston Edison Co.*, 53 F.P.C. 1545, 1563 (1975).

[4] Thus, for example, nonfirm rates charged to California customers include the fully-allocated costs of BPA's investment in the ill-fated nuclear power plants of the Washington Public Power Supply System ("WPPSS"), even though (i) those plants were not yet in service during the period at issue, and (ii) California customers would never have had equal access to the power produced by those plants.

unfairly forces California consumers to subsidize electricity prices in the Northwest.

The court of appeals' decision to approve the BPA's discriminatory rate order is wrong. Section 825s of the Flood Control Act specifically requires that rate schedules for the sale of all BPA power "shall be drawn having regard to the recovery . . . of the cost of producing and transmitting such electric energy," and that federal power shall be made available "on fair and reasonable terms and conditions." 16 U.S.C. § 825s. The court of appeals' approval of the BPA's order, however, is expressly premised upon the court's conclusion that Section 825s does not, in fact, impose a "fair and reasonable" ratemaking standard, and that the BPA is therefore *not* required to follow ordinary ratemaking principles in setting nonfirm rates.

The only basis for this conclusion is the court's assertion that Section 825s "does not refer to ratemaking per se, but rather to the overall requirement of fairness in the *delivery* of power by the BPA." Pet. App. A-17 (emphasis added). But that interpretation is contrary to the plain statutory language, not to mention common sense, for two reasons. *First*, Section 825s expressly encompasses "rate schedules." *Second*, that provision requires, without limitation, that *all* "terms and conditions" for the sale of federal power be "fair and reasonable." It is not limited to the "delivery" of power. The rate charged for electricity is obviously one of the "terms"—if not the most important term—of any contract for the sale of electricity. In short, there is simply no basis for permitting the BPA to escape normal ratemaking principles.[6]

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[6] The decision below on this issue is also wrong for the reasons stated in the petition for certiorari. Pet. 13-18. The CEC did not submit its own petition on this issue because, during the rate period in question, BPA was not able actually to recover its fully allocated costs. For that reason, it did not appear necessary to challenge the Ninth Circuit's holding at this time.

3. The court of appeals' holding that FERC lacked authority to hold a hearing in this case also warrants review because it will eliminate a vital check on the unauthorized discrimination against California practiced by the BPA. Recognizing BPA's natural tendency to be biased in favor of the Northwest, Congress enacted Section 7(k) of the Pacific Northwest Act (16 U.S.C. § 839e(k)), which provides for plenary review by the FERC of BPA "rates or rate schedules" applicable to nonfirm energy sold outside the Northwest. *Central Lincoln Peoples' Utility Dist.* v. *Johnson*, 735 F.2d 1101, 1113 (9th Cir. 1984). That section's plain language requires an opportunity for an independent ratemaking hearing by the FERC: Although Section 7(k) states that the FERC's review must be "*based* on the record of proceedings" before the BPA, it also provides that the parties to a FERC review proceeding "*shall* be afforded an opportunity by the Commission for an *additional* hearing in accordance with the procedures established for ratemaking by the Commission . . . ." *Id.* (emphasis added).

Notwithstanding the plain statutory language, the court of appeals rejected the FERC's interpretation of Section 7(k)—an interpretation that should be entitled to judicial deference[6]—and held that the FERC is barred by that provision from conducting any independent fact-finding. This holding is incorrect for the reasons stated in the petition for certiorari. Pet. 9-13.

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[6] *E.g.*, *Chevron, USA* v. *NRDC*, 467 U.S. 837 (1984). BPA argued before the FERC (but not in the court of appeals) that FERC should not hold an evidentiary hearing. Although the court of appeals did not purport to defer to the BPA's interpretation, the parties who challenged FERC's interpretation below strongly relied upon BPA's interpretation in urging the court of appeals to reverse the FERC on this point. Inasmuch as it involves conflicting interpretations of an important federal statute by two federal agencies, this case presents a deference issue analogous to that presented in *Ohio Power Co.* v. *FERC*, 880 F.2d 1400 (D.C. Cir. 1989), *cert. granted sub nom. Arcadia, Ohio* v. *Ohio Power Co.*, 110 S. Ct. 1522 (1990).

The court of appeals' holding has ramifications far beyond this case because it impairs the FERC's ability to prevent further interregional discrimination by the BPA. Plenary review by the FERC is the only protection California consumers have against unfair treatment. Under the decision below, however, the record of BPA's hearing—in which BPA selects and pays for the hearing officer, presents its own case, and drafts and adopts its own findings and conclusions—will be the sole source of evidence for FERC's review proceeding. Obviously, that limitation makes FERC ratemaking review more akin to judicial review than to the plenary review envisioned by Congress.

The hearing issue also has substantial practical importance in this case. Even if the court of appeals was correct in holding that the FERC lacked authority to hold an additional hearing, the proper course was to remand to the FERC so that it could exercise its statutory responsibility to review the BPA's rates in the first instance. A remand is especially important in light of the FERC's holding, acknowledged by the court of appeals (Pet. App. A-21), that it could *not* sustain the BPA's rates on the basis of the record compiled by the BPA. *Bonneville Power Admin.*, 23 FERC § 61,161 at 61,354 (1983). The court of appeals' decision to affirm the FERC's order on a ground not asserted—indeed, expressly disavowed—by the FERC is a stark violation of fundamental principles of administrative law. See, *e.g.*, *SEC* v. *Chenery*, 332 U.S. 194, 196 (1947).

Thus, if this Court were to agree with the court of appeals that the FERC lacked authority to hold an additional hearing, the decision below must, at a minimum, be vacated and the case remanded to the FERC. On the other hand, if the Court agrees with the petitioner (and CEC) that the FERC has this authority (and if the Court does not reverse the decision below on another ground), the proper course would be to affirm, but on the alternative ground that the FERC has authority to hold

an additional hearing and that it properly relied upon the additional evidence it amassed in this case.

In any event, it cannot be the proper resolution of this case simply to deny the petition and leave both the *Chenery* problem and the issue of FERC's authority to hold an additional hearing left unresolved. What makes the practical effect of the decision below particularly acute—and therefore worthy of review at this time—is that the Ninth Circuit is the only court that can review FERC decisions involving BPA rate orders. Thus, the protection against regional bias that an independent FERC hearing provides will be lost completely unless the FERC refuses to acquiesce in the decision below. That, obviously, would place the FERC in an awkward position in any future judicial review of a similar rate order. The better course would be for this Court to resolve the issue now.[7]

* * * * *

In sum, the two issues presented in the petition for certiorari are important questions of federal law which ought to be resolved by this Court. They directly affect millions of California consumers of electricity, forcing those consumers to subsidize their counterparts in the Pacific Northwest. And, inasmuch as the Ninth Circuit has exclusive jurisdiction over all appeals involving BPA orders, no direct circuit conflict could possibly arise as to the issues presented here or, indeed, any other issues of discrimination by the BPA. For that reason, review should be granted.

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[7] CEC did not petition for certiorari on this issue because it was not clear that the CEC would necessarily benefit from a reversal of the court of appeals' holding on the issue in *this* case. Given that the FERC ultimately approved the rate order at issue here, a holding that the FERC was entitled to base its decision on the additional evidence taken during the FERC's own hearing would not change the result. It is the policy of the CEC to bring to this Court only issues of immediate legal *and* practical significance to the CEC. This issue, in the CEC's view, did not qualify under that strict standard.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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No. 90-505

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In the Supreme Court of the United States

OCTOBER TERM, 1990

CALIFORNIA PUBLIC UTILITIES COMMISSION,
PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION AND
BONNEVILLE POWER ADMINISTRATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission (FERC) is authorized by Section 7(k) of the Pacific Northwest Electric Power Planning and Conservation Act to hold an evidentiary hearing for the purposes of supplementing the record in connection with its review of nonfirm rates established by the Bonneville Power Administration (BPA).

2. Whether FERC's orders approving nonfirm rates set by BPA were supported by substantial evidence.

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OCTOBER TERM, 1990

No. 90-505

CALIFORNIA PUBLIC UTILITIES COMMISSION,
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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A34) is reported at 903 F.2d 585. The orders of the Federal Energy Regulatory Commission (Pet. App. C1-C41, D1-D9) are reported at 36 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,335 and 39 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,033.

JURISDICTION

The judgment of the court of appeals was entered on December 11, 1989. Petitions for rehearing were denied on June 21, 1990. Pet. App. B1-B2. The petition for a writ of certiorari was filed on September

19, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Bonneville Power Administration (BPA) is a self-financing agency within the United States Department of Energy. BPA markets power from thirty federal hydroelectric projects and two nuclear power plants known collectively as the Federal Columbia River Power System. BPA also purchases power and carries out energy conservation programs. The Columbia River System includes a network of dams and reservoirs capable of storing approximately 40% of the average annual streamflow of the Columbia River. Despite this large storage capacity, BPA lacks sufficient water to operate its hydroelectric generating facilities at full capacity throughout the year. BPA plans to meet its "firm power" loads on the assumption that streamflows will equal the lowest flows on record. *United States Dep't of Energy—Bonneville Power Admin.*, 29 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 63,039, at 65,123 (1984).[1] As a result of this conservative assumption, the Columbia River System produces very large amounts of nonfirm energy in four out of every five years. *Ibid.* BPA operates the system so as to maximize the production of useful energy. Pet. App. C6-C7.

BPA's reservoirs integrate its hydroelectric and thermal generating capacity. By operating its thermal generators (or by purchasing power from other sources), BPA is able to accumulate water in its

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[1] "Firm power" is energy that BPA expects to produce under predictable streamflow conditions. "Nonfirm power" is energy in excess of firm power. *Aluminum Co. of America* v. *Central Lincoln Peoples' Utility District*, 467 U.S. 380, 383 (1984).

reservoirs that can be used to generate electricity at a later time. Consequently, energy produced by water released from a reservoir of the Columbia River System may result from the expenditure of thermal resources, streamflows, or a combination of the two. Because the system relies heavily on hydroelectric generation, and because it stores large amounts of potential energy by expending thermal and purchased resources (as well as through conservation programs), it is not feasible for BPA to attribute an increment of nonfirm energy to the resource that produced it. Consequently, it is not feasible for BPA to ascertain the incremental cost of a unit of energy. BPA can, however, determine the total cost of producing a quantity of energy over time and derive an average cost per unit from this figure. Pet. App. C7-C8.

2. In 1964 Congress enacted the Pacific Northwest Consumer Power Preference Act, 16 U.S.C. 837 *et seq.*, which prohibits the sale of electric energy from federal hydroelectric facilities in the Columbia River System to customers outside the Pacific Northwest region unless there is no market for the power in the Pacific Northwest at the established rate. In 1980, Congress enacted the Pacific Northwest Electric Power Planning and Conservation Act (the Regional Act), which among other things authorizes the Administrator of BPA to sell surplus firm and nonfirm power pursuant to the preference provisions of the 1964 Act, 16 U.S.C. 839c(f), 839f(c), and requires BPA to establish rates sufficient to cover BPA's costs.[2] Section 7(k) of the Regional Act au-

[2] Section 7(a) of the Regional Act provides in pertinent part that BPA's rates

> shall be established and, as appropriate, revised to recover, in accordance with sound business principles, the

thorizes FERC to review BPA's nonfirm rates applicable to customers outside the Pacific Northwest region to determine whether the rates comply with the standards of the Federal Columbia River Transmission System Act, 16 U.S.C. 838g-h, the Flood Control Act of 1944, 16 U.S.C. 825s, and the Bonneville Project Act of 1937, 16 U.S.C. 832e-f.[3]

3. This case involves two nonfirm rates, known as NF-1 and NF-2, established by the Administrator of BPA under Section 7(k) of the Regional Act for

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> costs associated with the acquisition, conservation, and transmission of electric power, including the amortization of the Federal investment in the Federal Columbia River Power System * * * over a reasonable period of years and the other costs and expenses incurred by the Administrator pursuant to this chapter and other provisions of law.

16 U.S.C. 839e(a)(1).

[3] Section 7(k) of the Regional Act provides in pertinent part:

> Notwithstanding any other provision of this chapter, all rates or rate schedules for the sale of nonfirm electric power within the United States, but outside the region, shall be established * * * in accordance with the procedures of subsection (i) of this section. * * * [S]uch rates or rate schedules shall become effective after review by the Federal Energy Regulatory Commission for conformance with the requirements of such Acts and after approval thereof by the Commission. Such review shall be based on the record of proceedings established under subsection (i) of this section. The parties to such proceedings under subsection (i) of this section shall be afforded an opportunity by the Commission for an additional hearing in accordance with the procedures established for ratemaking by the Commission pursuant to the Federal Power Act.

16 U.S.C. 839e(k).

sales of nonfirm energy from July 1981 through October 1983. Pet. App. A9. The NF-1 and NF-2 rates applied to nonfirm customers in the Pacific Northwest region as well as to customers located outside that region. The rates were challenged by a group of Pacific Northwest customers, who contended that they were too low, and also by a group of California customers and regulators, who contended that the rates were too high.

4. Before FERC, BPA and other parties took the position that Section 7(k) requires FERC to base its review solely on the administrative record compiled by BPA. Pet. App. A21-A22 & n.9. FERC nevertheless instructed an administrative law judge to conduct an evidentiary hearing to supplement the record compiled by BPA. In November 1984, following a hearing, the ALJ issued an initial decision concluding that the NF-1 and NF-2 rates resulted in undercharges to California customers and disapproving the rates. *United States Dept. of Energy—Bonneville Power Admin.*, 29 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 63,039 (1984).

In September 1986, FERC issued an opinion rejecting the ALJ's conclusions and approving the rates as filed by BPA. Pet. App. C1-C41. FERC found that the NF-1 and NF-2 rates met the standards established by the statutes enumerated in Section 7(k) of the Regional Act.[4] Pet. App. C33-C36. As to the

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[4] As summarized by FERC, those statutes require BPA to design rates (1) "having regard to the recovery of the cost of generation and transmission of such electric energy"; (2) "so as to encourage the most widespread use of BPA power"; (3) "to provide the lowest possible rates to consumers consistent with sound business principles"; and (4) "in a manner which protects the interests of the United States in

contention of the Pacific Northwest customers that BPA's rates for sales to California were too low because they resulted in below-cost sales, FERC explained that "[i]f the market for energy does not ultimately turn out to be what BPA had expected at the time it was storing energy in its reservoirs, it may be necessary for BPA to lower its price below what it cost to produce the stored energy * * * rather than to have it be wasted through spill." Pet. App. C36. FERC also rejected arguments by the California parties that the rates for sales to California were too high. The California parties contended that BPA's nonfirm rate should have been derived from BPA's incremental cost (*i.e.*, the cost of producing an additional unit of energy) rather than from an unweighted proportionate share of BPA's full costs. FERC found that there was no feasible way for BPA to design the rates to reflect incremental cost. Because BPA's power is produced from a mix of hydroelectric and thermal sources, the incremental cost of production cannot be determined. Pet. App. C7-C8. FERC reaffirmed its conclusions in an opinion denying petitions for rehearing. Pet. App. D1-D9.

5. On appeal, the court of appeals concluded that FERC lacked authority to hold an evidentiary hearing to supplement the record, but affirmed FERC's decision on the merits. The court rejected FERC's contention that the agency is authorized under Section 7(k) of the Regional Act to conduct an evidentiary hearing if it determines that the record compiled by BPA is inadequate. The court concluded that FERC's position is inconsistent with other pro-

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amortizing its investments in the projects within a reasonable period." Pet. App. C2-C3.

visions of the Regional Act that require BPA to develop "a full and complete record" (16 U.S.C. 839e (i)(2)) and to come to a final decision based on that record (16 U.S.C. 839e(i)(5)); that require FERC to base its review and approval on the record compiled by BPA (16 U.S.C. 839e(k)); and that require the court of appeals to base its review on the record compiled by BPA (16 U.S.C. 839f(e)(2)). Pet. App. A19, A22-A23. The court noted that it was deciding "only that FERC may not hold an evidentiary hearing to supplement a record it thinks is inadequate." It expressly left open the possibility that "other circumstances" might permit FERC to hold an evidentiary hearing. *Id.* at A23.

The court of appeals then held that FERC's confirmation of the NF-1 and NF-2 rates was supported by substantial evidence in the record compiled before BPA. The court upheld FERC's finding that it is not feasible to determine the incremental cost of nonfirm energy produced by the Columbia River System. Pet. App. A24-A25. Accordingly, the court rejected the California parties' contention that the nonfirm rates should have been designed on an incremental basis rather than on an unweighted proportional basis. The court also rejected the Northwest parties' contention that the rates were too low since they did not fully recover BPA's costs. The court agreed with FERC that BPA's decision to cap the rates at cost, while allowing sales below cost in circumstances where the energy might otherwise be wasted, satisfied the statutory requirement that BPA encourage widespread use of BPA power at the lowest possible rates consistent with sound business principles. Pet. App. A30-A33. The court emphasized that the Regional Act does not require BPA to design rates in any particular way, and concluded that the NF-1 and

NF-2 rates met the standards of Section 7(k). Pet. App. A30-A33.

ARGUMENT

The court of appeals reasonably concluded that FERC lacks authority under Section 7(k) of the Regional Act to conduct an evidentiary hearing for the purpose of supplementing the record compiled before BPA. Because FERC has now acquiesced in the court of appeals' narrow resolution of this issue, further review is not warranted. In addition, the court of appeals' fact-bound decision affirming the NF-1 and NF-2 rates does not merit review by this Court.[5]

1. Petitioner contends (Pet. 9-13) that FERC is authorized under Section 7(k) of the Regional Act to hold an evidentiary hearing as part of its review of rates set by BPA. This contention does not warrant further review—especially in light of the fact that FERC ruled *against* petitioner on the basis of the record as supplemented by the evidentiary hearing FERC in fact held.

In any event, following the decision of the court of appeals in this case, FERC decided to acquiesce in the court's resolution of this issue. In a recent decision, FERC stated that

> In Aluminum Company of America v. Bonneville Power Administration, 903 F.2d 585, 591-

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[5] There is no basis for petitioner's suggestion (Pet. 8) that the NF-1 and NF-2 rates made BPA an uneconomic source of supply for California customers. On the contrary, the court of appeals noted that California utilities saved some $1.5 billion by purchasing power from BPA at the NF-1 and NF-2 rates. Pet. App. A30 n.14. BPA, on the other hand, realized only $270 million in NF-1 and NF-2 revenues. During the period that the rates were in effect, moreover, BPA's revenue shortfalls exceeded $680 million. *Ibid.*

> 94 (9th Cir. 1990), the Ninth Circuit held that the Commission may not hold an evidentiary hearing under section 7(k) to supplement a record we think is inadequate. The court did not completely foreclose the possibility that an evidentiary hearing could be held under other circumstances. *Id.* at 594. However, since the Commission agrees with the Ninth Circuit's decision, we do not anticipate evidentiary hearings in future section 7(k) proceedings.

United States Department of Energy—Bonneville Power Administration, Docket No. 87-2011-005 (Nov. 14, 1990) slip op. 10 n.28.[6] Thus, FERC and BPA now agree with the regional court of appeals—which has exclusive jurisdiction to review questions arising under Section 7(k), 16 U.S.C. 839f(e)(5)—that FERC is not authorized to hold an evidentiary hearing for the purpose of supplementing the record under Section 7(k). Because the issue is unlikely to arise in future cases, it does not merit the attention of this Court.

Petitioner contends that the court of appeals failed to accord sufficient deference to FERC's (former) interpretation of Section 7(k). But BPA—the agency that drafted the Regional Act—consistently has taken the position that FERC is not authorized to conduct an evidentiary hearing to supplement BPA's record. This Court has recognized that "the [BPA] Administrator's interpretation of the Regional Act is to be given great weight." *Aluminum Co. of America* v. *Central Lincoln Peoples' Utility District*, 467 U.S. 380, 389 (1984). It is true that FERC's recent decision to adopt BPA's view, to the extent that it conflicts with its earlier interpretation,

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[6] FERC's decision is reprinted as an appendix to this brief. (See App., *infra*, 13a-14a).

may be entitled to less deference than a consistently held agency view. See *INS* v. *Cardoza-Fonseca*, 480 U.S. 421, 446-447 n.30 (1987) (quoting *Watt* v. *Alaska*, 451 U.S. 259, 273 (1981)). But FERC's change of position is not as dramatic as it might appear to be. Before this case reached the court of appeals, FERC recognized that "[t]here may be merit to BPA's argument that * * * an additional hearing need not be an evidentiary hearing and that the mandate of [Section 7(k)] may be fulfilled, instead, by providing the parties with the opportunity to file briefs or written comments." 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,469, at 62,024.

The court of appeals' resolution of this issue is both reasonable and narrowly limited to the situation presented in this case. It is true that the last sentence of Section 7(k) affords the parties an opportunity for "an additional hearing in accordance with the procedures established for ratemaking by the Commission pursuant to the Federal Power Act." But as the court of appeals observed (Pet. App. A19), Section 7(k) also requires FERC to review BPA's rates "based upon the record of proceedings established under subsection (i) [codified at 16 U.S.C. 839e(i)] of this section." And the court of appeals is required to determine whether FERC's decisions are "supported by substantial evidence in the rulemaking record required by section 839e(i) of this title considered as a whole." 16 U.S.C. 839f(e)(2). The record required by Section 839e(i) is the record compiled at an evidentiary hearing before BPA.[7]

[7] Petitioner contends (Pet. 10) that review "[b]ased on" the record does not mean review "limited to" the record. But it is difficult to see how a decision that relies on facts not in the BPA record could be "based on" that record.

Moreover, as this Court noted in construing analogous provisions of Section 5 of the Flood Control Act of 1944, 16 U.S.C. 825s, FERC views its role in reviewing hydroelectric rates established by federally-owned projects as " 'in the nature of an appellate body.' * * * In exercising that appellate function, FERC relies on the record before it, remanding for supplementation if necessary." *United States* v. *City of Fulton*, 475 U.S. 657, 663 (1986) (quoting 45 Fed. Reg. 79,545, 79,547 (1980)).[8] In view of the other provisions of the statute and the appellate nature of FERC's review, the court of appeals reasonably concluded that the additional hearing before FERC afforded by Section 7(k) may not be an evidentiary hearing for the purpose of supplementing the record.

Finally, this is the first case to come before FERC (and, consequently, the court of appeals) under Section 7(k). See Pet. App. C2. Moreover, the Ninth Circuit's decision is narrowly confined to the circumstances of the case. In deciding that FERC "may not hold an evidentiary hearing to supplement a record it thinks is inadequate," the court expressly left open the possibility that an evidentiary hearing could be held "under other circumstances." Pet. App. A23. Because the hearing question may arise in a variety of factual and procedural contexts in future cases, further review in this case would be premature.[9]

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[8] Because FERC may conduct a non-evidentiary hearing, and may also remand to BPA to supplement the record if necessary, there is no basis for petitioner's assertion (Pet. 12-13) that California customers will be denied the opportunity for an impartial hearing.

[9] Respondent California Energy Commission (CEC) contends that the court of appeals, having determined that

2. Contrary to petitioner's contentions (Pet. 13-18), the court of appeals correctly held that FERC's confirmation of the NF-1 and NF-2 rates is supported by substantial evidence in the record. None of the fact-specific issues raised by petitioner warrants review by this Court.[10]

Petitioner renews its argument (Pet. 14-15) that BPA may not charge its nonfirm customers more

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FERC lacked authority to conduct an evidentiary hearing, was required to remand the case to FERC rather than affirming its decision. CEC Br. 9 (citing *SEC* v. *Chenery Corp.*, 332 U.S. 194, 196 (1947)). Because this contention is not presented in the petition for certiorari, or fairly included in the questions presented, it should not be considered by this Court. See Supreme Court Rule 14.1(a). We note that respondent CEC has not filed a cross-petition for a writ of certiorari. See Supreme Court Rule 12.3. In any event, *Chenery* held that a court may not affirm the decision of an administrative agency on a ground not asserted by the agency. Here, the court of appeals did not affirm on a ground not asserted by FERC, but rather affirmed FERC's findings and conclusions on the basis of substantial evidence in the BPA record. See 16 U.S.C. 839f(e)(2). Even if the *Chenery* doctrine were applicable here, it would require a remand only if there were a significant possibility that, but for the error, the agency would in fact have reached a different result. *NLRB* v. *Wyman-Gordon Co.*, 394 U.S. 759, 766 n.6 (1969) (plurality opinion). If FERC had determined at the outset that it could not hold an evidentiary hearing, it presumably would have directed BPA to receive additional evidence. There is no reason to think that additional evidence presented to BPA would have differed from the evidence presented to FERC, or that FERC would have reached a different decision on the merits.

[10] Respondent CEC focuses much of its attention on BPA's policy for allocating excess transmission capacity—a policy that it concedes is "not before this Court." CEC. Br. 4.

than the incremental cost of the energy they consume, and consequently is prohibited from designing rates that reflect nonfirm customers' unweighted proportional share of BPA's full costs. Petitioner disparages, as "fallac[ious]," (Pet. 14) the findings of FERC, unheld by the court of appeals, that BPA operates its system to maximize the production of useful energy and that BPA cannot feasibly determine the incremental cost of its output. But petitioner offers no persuasive reason for this Court to reexamine those fact-bound determinations. Contrary to petitioner's suggestion, the fact that BPA decides whether to invest in *additional* generating capacity on the basis of anticipated demand in the Pacific Northwest region does not imply that BPA operates *existing* facilities solely for the benefit of customers in that region. And while petitioner asserts the BPA is no less able to determine its incremental costs than other utilities, it does not dispute FERC's findings that the Columbia River System is unique because of its heavy reliance on hydropower and its substantial storage capacity. Pet. App. C6.

Contrary to petitioner's assertion (Pet. 15), it is not "beside the point" that FERC found that BPA's California customers benefit from BPA's entire system. The fact that California customers benefit from BPA's entire system affords a basis for allocating a proportional share of the system's full costs to those customers. Pet. App. A25. Moreover, there is no basis for petitioner's assertion (Pet. 16-17) that FERC "ignored its responsibilities" by failing to determine whether BPA's rates encouraged the most widespread use of nonfirm energy at the lowest possible price. FERC expressly found that BPA's rates

encouraged "widespread use" and the lowest possible rates consistent with sound business principles. Pet. App. C35-C36, D6-D7. The court of appeals concluded that the rates were consistent with the "widespread use" standard. Pet App. A33. Petitioner errs in suggesting (Pet. 17-18) that the rates approved by FERC were inconsistent with sound business principles. The nonfirm energy revenues collected under the rates at issue here contributed to BPA's overall cost recovery. All BPA revenues are statutorily required to be used to pay BPA's costs and scheduled amortization. See 16 U.S.C. 839e (a)(1). It is thus incorrect for petitioner to suggest (Pet. 17) that revenues from nonfirm service serve only to reduce rates for firm service. FERC's administrative law judge correctly rejected this argument, recognizing that "the nonfirm customers should pay those costs which in essence have been allocated to them." 29 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 63,039, at 65,083.

Finally, there is no merit to petitioner's contention that BPA's costs associated with the Washington Public Power Supply System (WPPSS) nuclear plants should not have been charged to BPA's nonfirm customers. See Pet. 18. According to petitioner, the costs associated with these plants should not have been included in BPA's rates because the WPPSS plants did not produce energy during the period at issue here. But as the court of appeals observed (Pet. App. A28), if BPA were required to pay its WPPSS obligations but prevented from charging ratepayers for them until the WPPSS plants produced energy, funds to repay federal investment in the Columbia River System would have to be diverted, contrary to the purposes of Section 7(k). Thus, inclusion of WPPSS costs was permissible to meet BPA's con-

tractual obligations to pay for purchased power on a current basis and to amortize federal investment within a reasonable time. *Ibid.*

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. EF87-2011-005

Before Commissioners: Martin L. Allday, Chairman;
Charles A. Trabandt,
Elizabeth Anne Moler,
Jerry J. Langdon
and Branko Terzic.

UNITED STATES DEPARTMENT)
OF ENERGY—BONNEVILLE)
POWER ADMINISTRATION)

ORDER GRANTING REHEARING

(Issued November 14, 1990)

On May 16, 1988, the Bonneville Power Administration (Bonneville), the Northwest Parties,[1] the California Utilities,[2] and the M-S-R Public Power

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[1] The "Northwest Parties" refers to the Public Power Council, the Association of Public Agency Customers, the Public Generating Pool, the Pacific Northwest Generating Company, and the Direct Service Industries.

[2] The "California Utilities" refers to Southern California Edison Company, the Department of Water and Power of the City of Los Angeles, the Public Service Department of the City of Glendale, the Public Service Department of the City

Agency (M-S-R)[3] filed separate requests for rehearing[4] of the Commission's April 6, 1988 order[5] issued in Docket No. EF87-2011-003.[6]

Background

The April 6, 1988 order rejected Bonneville's SL-87 rate schedule, the rate schedule for long-term surplus firm power, as insufficiently specific within the meaning of section 300.1 of the Commission's regulations.[7] The Commission also ruled that all of Bonne-

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of Burbank, and the Water and Power Department of the City of Pasadena.

[3] "M-S-R" consists of the Modesto Irrigation District, the City of Santa Clara, and the City of Redding. M-S-R was formed to acquire, construct, maintain, and operate generation and transmission facilities for the benefit of its members.

[4] Bonneville, the Northwest Parties and M-S-R raise similar issues and will be referred to as the petitioners.

[5] On April 25 and April 28, 1988, Bonneville and the Northwest Parties filed motions for an extension of time to file requests for rehearing. On May 3, 1988, the Commission granted a waiver of the Commission's regulations to allow an extension of time to file requests for rehearing until May 16, 1988.

[6] United States Department of Energy—Bonneville Power Administration, 43 FERC ¶ 61,032 (1988).

[7] 43 FERC at 61,086; *see also* 18 C.F.R. § 300.1 (1990). On April 14, 1988, Bonneville filed a request for a stay of further Commission action on all pending Bonneville rate filings until the Commission acted on the pending rehearing request or until August 8, 1988, the end of the 120-day period provided for the filing of a substitute for the rejected SL-87 rate schedule. On April 27, 1988, the Northwest Parties filed a motion in support of Bonneville's motion for stay. On April 28, 1988, the California Utilities filed an answer in opposition to Bonne-

ville's rates covering sales outside the Pacific Northwest region,[8] whether classified by Bonneville as either "firm" or "nonfirm" sales,[9] must meet the standards of review of section 7(k) of the Pacific Northwest Power Planning and Conservation Act (Northwest Power Act).[10]

In addition, the April 6, 1988 order addressed future rate filings for non-regional sales which provide

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ville's motion requesting a stay. The Commission took no action on the request for a stay.

On August 3, 1988, Bonneville requested an extension of four days to file its substitute rates for the rejected SL-87 rate schedule. The extension was granted. On August 12, 1988, as completed on October 14, 1988, Bonneville filed its substitute for the SL-87 rate schedule (Modified SL-87) in Docket No. EF87-2011-007. The Commission granted interim approval to the Modified SL-87 rate schedule on December 1, 1988. United States Department of Energy—Bonneville Power Administration, 45 FERC ¶ 61,358 (1988).

[8] The Pacific Northwest region means:

> "(A) the area consisting of the States of Oregon, Washington, and Idaho, the portion of the State of Montana west of the Continental Divide, and such portions of the States of Nevada, Utah, and Wyoming as are within the Columbia River drainage basin; and
>
> (B) any contiguous areas, not in excess of seventy-five air miles from the area referred to in subparagraph (A), which are a part of the service area of a rural electric cooperative customer served by the Administrator on the effective date of this Act which has a distribution system from which it serves both within and without such region."

16 U.S.C. § 839a(14) (1988).

[9] *Cf.* Southern California Edison Company v. Jura, 909 F.2d 339, 341 n.1 (9th Cir. 1990) (discussion of what Bonneville classifies as "firm" and "nonfirm" power).

[10] 43 FERC at 61,086-88; *see also* 16 U.S.C. § 839e(k) (1988).

Bonneville with a significant degree of flexibility in pricing. The Commission stated, *inter alia*, that Bonneville must demonstrate, in any such future rate filings, that the pricing flexibility sought would not result, due to Bonneville's market power, in prices inconsistent with the encouragement of the most widespread use of Bonneville's power at the lowest possible rate consistent with sound business principles.[11]

On May 16, 1988, Bonneville filed a request for rehearing. Bonneville alleges that the Commission erred in concluding that section 7(k) of the Northwest Power Act applies to all Bonneville sales outside the Pacific Northwest region. Bonneville also states that the Commission erred by precluding Bonneville from making firm sales outside the Pacific Northwest region. In addition, Bonneville claims that the April 6, 1988 order attempts to review Bonneville's transmission policies, which exceeds the scope of the Commission's regulatory authority. Bonneville also alleges that the Commission erroneously asserted jurisdiction over Bonneville's extraregional marketing in violation of the Commission's regulatory authority. Finally, Bonneville asserts that if the Commission plans to examine the cost basis for the surplus firm power rate in the ordered evidentiary hearing, Bonneville is entitled to recover its firm power cost to repay the Federal treasury.

On May 16, 1988, the Northwest Parties filed a request for rehearing. The Northwest Parties support the Commission's rejection of the SL-87 rate schedule. However, they disagree with those portions of the April 6, 1988 order which require all nonregional power sales to be reviewed under section

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[11] 43 FERC at 61,088.

7(k). The Northwest Parties argue that the definition of firm power in the April 6, 1988 order conflicts with the definitions used by the courts. In addition, the Northwest Parties assert that the Commission's reversal of prior, long-standing law and policy without notice and opportunity to comment violates due process, and that the Commission appears to have failed to consider the extensive implications of the reversal on sales contracts other than Bonneville's. The Northwest Parties also assert that "market power" is an inappropriate standard for Bonneville. The Northwest Parties state that there was no evidence presented to demonstrate that Bonneville has exercised market power, and they claim that the burden of proof that such power exists is properly on a party claiming injury from the exercise of market power.

On May 16, 1988, the California Utilities filed a request for rehearing seeking clarification of the effect of the April 6, 1988 order on Bonneville's 1985 rates. The California Utilities request that the Commission clarify that portion of the April 6, 1988 order which addressed the SP-85 rate schedule pending in Docket No. EF85-2011-000. The California Utilities ask the Commission to rule that sales made under Bonneville's SP-85 rate schedule, the short-term surplus firm power rate schedule, must be sold under the NF-85 rate schedule, Bonneville's nonfirm energy rate schedule. The California Utilities do not, however, disagree with the Commission's decision that all non-regional rates must be reviewed under section 7(k).

On May 16, 1988, M-S-R filed a motion to intervene out of time in this proceeding arguing that M-S-R was unaware before the April 6, 1988 order that the Commission would rule that all of Bonneville's non-

regional sales are "nonfirm" sales. On May 16, 1988, M-S-R also filed a request for rehearing of the April 6, 1988 order. M-S-R argues that the order departs from precedent, is erroneous, could substantially and adversely affect the power markets within the Pacific Northwest region and in California, and could adversely affect potential purchasers from Bonneville.

On May 31, 1988, the Public Utility Commission of Oregon (Oregon Commission) filed an untimely motion to intervene. The Oregon Commission expresses concern about the Commission's reading of sections 7(a)(2) and 7(k) of the Northwest Power Act.

On June 9, 1988, the Washington Water Power Company (Washington Water Power) filed an untimely motion to intervene, raising no issues.

On March 2, 1990, Bonneville filed a motion to lodge the Ninth Circuit Court of Appeals' opinion, *Aluminium Company of America v. Bonneville Power Administration*, 891 F.2d 748 (9th Cir. 1989), which affirmed the Commission's final approval and confirmation of Bonneville's 1981 and 1982 nonfirm energy rates. Bonneville also moved to vacate the Commission's April 6, 1988 order. Bonneville further moved to supplement its answer in opposition to the comments of the intervenors.[12]

On March 13, 1990, the California Utilities filed motions to dismiss Bonneville's motion to lodge, motion to vacate, and motion to supplement or, in the alternative, to extend the time to answer Bonneville's motions.

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[12] On April 27, 1988, prior to its filing of the instant rehearing, Bonneville filed an answer in opposition to the California Utilities' motion to lodge an order and supplement its briefs.

On March 19, 1990, Puget Sound Power & Light Company (Puget) filed an answer to Bonneville's March 2, 1990 motions stating that it does not object to Bonneville's motions.

On March 23, 1990, Washington Water Power filed a renewal of its motion to intervene, stating that it joins Puget's response to Bonneville's March 2, 1990 motion.

On April 9, 1990, the California Utilities again filed in opposition to Bonneville's March 2, 1990 motion, contending that Bonneville's motion is premature and irrelevant to the April 6, 1988 order.

On May 30, 1990, Bonneville filed a motion to lodge the amended Ninth Circuit opinion in *Aluminum Company of America v. Bonneville Power Administration*, 903 F.2d 585 (9th Cir. 1990),[13] as a supplement to Bonneville's previously filed motion to lodge.

Discussion

We find that good cause exists to grant the untimely and unopposed motions to intervene of M-S-R, Washington Water Power and the Oregon Commission, given the interest of the constituencies which they represent and the absence of any undue prejudice or delay.[14]

In their requests for rehearing, the petitioners allege several errors in the April 6, 1988 order. First, the petitioners contend that section 7(k) of the Northwest Power Act does not grant the Commission juris-

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[13] *Reh'g denied*, 909 F.2d 339 (9th Cir. 1990), *petition for cert. filed*, 59 U.S.L.W. 3278 (U.S. September 19, 1990) (No. 90-505).

[14] *See* 18 C.F.R. § 385.214(a)(2) (1990).

diction to review Bonneville's extraregional surplus firm power rates and that Bonneville is authorized to sell surplus firm power outside the region. Second, the petitioners state that Bonneville's statutory mandate to market surplus power is separate and distinct from statutory provisions under which Bonneville develops rates subject to Commission review. Therefore the petitioners argue that the Commission has no authority over Bonneville marketing activities. Third, Bonneville asserts that the Commission's conclusion that all extraregional power sales are nonfirm infringes upon Bonneville's marketing authority, is inconsistent with industry practice, and contradicts Bonneville's organic statutes.

Bonneville also states that it must still recover its firm power cost even if the Commission adheres to its conclusion that Bonneville firm power sales outside the Pacific Northwest are nonfirm.

Extraregional Sales of Firm Power

The petitioners claim, *inter alia*, that the Commission failed to recognize rulings by the Ninth Circuit Court of Appeals in arriving at its decision in its April 6, 1988 order disapproving Bonneville's SL-87 rate schedule. In light of the arguments made on rehearing and our review of recent Ninth Circuit precedent, the Commission has reexamined its ruling that any sale of power outside the Pacific Northwest region must be reviewed as a sale of nonfirm power under section 7(k). Upon further consideration, we find that this interpretation is incorrect, and, accordingly, we will grant rehearing.

Section 7(k) of the Northwest Power Act provides in pertinent part:

> [A]ll rates or rate schedules for the sale of nonfirm electric power within the United States, but outside the region, shall be established . . . by the Administrator in accordance with the procedures of subsection (i) of this section . . . and in accordance with the Bonneville Project Act, the Flood Control Act of 1944, and the Federal Columbia River Transmission System Act . . . . [S]uch rates or rate schedules shall become effective after review by the Federal Energy Regulatory Commission for conformance with the requirements of such Acts . . . .[15]

The Ninth Circuit in *Aluminum Company of America v. Bonneville Power Administration*, 903 F.2d 585 (9th Cir. 1990), pointed out that in interpreting section 7(k) the Commission should not render meaningless any of the provisions of section 7(k); no clause, sentence or word should be rendered superfluous, void, contradictory, or insignificant.[16] The Commission's interpretation of section 7(k) in the April 6, 1988 order failed to give weight to the word "nonfirm" in the statute. To treat all sales outside the Pacific Northwest region as sales of nonfirm power renders meaningless the statute's attention to both nonfirm and firm power, and section 7(k)'s express attention to only nonfirm power.

In *Central Lincoln Peoples' Utility District v. Johnson*, 735 F.2d 1101 (9th Cir. 1984), the Ninth Circuit found that, in fact, the majority of power

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[15] 16 U.S.C. § 839e(k) (1988).

[16] 903 F.2d at 594 (quoting Ruiz v. Morton, 462 F.2d 818, 820 (9th Cir. 1972), which, in turn, quotes Rockbridge v. Lincoln, 449 F.2d 567, 571 (9th Cir. 1971), *aff'd*, 415 U.S. 199 (1974)).

sold outside the Pacific Northwest region is nonfirm.[17] However, under section 9(c) of the Northwest Power Act,[18] only "surplus energy" and "surplus peaking" capacity may be sold outside the Pacific Northwest.[19] The question thus is whether surplus energy or surplus peaking capacity can ever be considered firm power.

The Northwest Power Act answers that question in the affirmative; surplus power can be firm power. The Northwest Power Act recognizes the difference between surplus firm and surplus nonfirm power in section 5(f). Section 5(f) provides, in pertinent part:

> The Administrator is authorized to sell, or otherwise dispose of, electric power, including power acquired pursuant to this and other Acts, that is surplus to his obligations incurred pursuant to subsections (b), (c), and (d) of this section in accordance with this and other Acts applicable to the Administrator . . . .[20]

Subsections (b), (c) and (d) provide for sales to Pacific Northwest regional customers. These customers are Pacific Northwest public, investor-owned utility and industrial customers.[21] What power re-

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[17] 735 F.2d at 1112.

[18] 16 U.S.C. § 839f(c) (1988).

[19] 735 F.2d at 1112.

[20] 16 U.S.C. § 839c(f) (1988).

[21] Sections 5(b), (c), and (d) provide in pertinent part:

(b) (1) Whenever requested, the Administrator shall offer to sell to each requesting public body and cooperative entitled to preference and priority under the Bonneville Project Act of 1937 and to each requesting investor-

mains once these customers' needs are met may be sold pursuant to section 5(f). That provision does not limit the Administrator's sales of surplus power to only nonfirm power once the Pacific Northwest regional customers' needs are met, but instead allows sales of surplus power without limitation to nonfirm power. Accordingly, we find that the Northwest Power Act recognizes surplus power can be firm, and separate and apart from nonfirm. We thus conclude that the Commission's earlier order erroneously equated surplus power and nonfirm power.[22] The two are not necessarily the same.

Furthermore, section 7(k) by its terms speaks only of *nonfirm* power sales outside the Pacific Northwest.[23] If all power sales outside the Pacific Northwest, as distinct from only nonfirm power sales, were to be subject to section 7(k), the reference to nonfirm power sales would be superfluous. That section 7(k) speaks only of nonfirm power sales means that those

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owned utility electric power to meet the firm power load of such public body, cooperative or investor-owned utility in the Region . . . .

(c)(1) Whenever a Pacific Northwest electric utility offers to sell electric power to the Administrator at the average system cost of that utility's resources in each year, the Administrator shall acquire by purchase such power and shall offer, in exchange, to sell an equivalent amount of electric power to such utility for resale to that utility's residential users within the region.

(d)(1)(A) The Administrator is authorized to sell in accordance with this subsection electric power to existing direct service industrial customers. Such sales shall provide a portion of the Administrator's reserves for firm power loads within the region.

[22] *See* 43 FERC at 61,087.

[23] 16 U.S.C. § 839e(k) (1988).

power sales outside the Pacific Northwest that are not nonfirm power sales are not subject to section 7(k)—*i.e.*, that firm power sales can be made outside the Pacific Northwest and that such sales are not subject to section 7(k).

Moreover, under the Northwest Power Act, power resources are considered surplus when there is no market or demand for them at an established rate within the Pacific Northwest.[24] That is, surplus power is power in excess of what customers within the Pacific Northwest region are willing to buy at the rate Bonneville offers the power. In contrast, under the Northwest Power Act, nonfirm energy is energy in excess of that which Bonneville can reliably plan on producing, based on estimates that water levels used for power generation will at times be low or critical.[25]

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[24] 16 U.S.C. § 839f(e) (1988); *see also* 903 F.2d at 588-89; *accord*, 909 F.2d at 340; 735 F.2d at 1112; California Energy Commission v. Bonneville Power Administration, 909 F.2d 1298, 1303 (9th Cir. 1990).

[25] 909 F.2d at 341 n.1 (" 'Nonfirm' is an accounting term. Devising a worst case scenario from historical data on streamflows, [Bonneville] calculates the minimum amount of energy it is likely to produce during a given period in the future, and designates this amount as its 'firm power' for that period; it refers to all energy in excess of that amount as 'nonfirm power.' "); Central Lincoln Peoples' Utility District v. Johnson, 686 F.2d 708, 710 (9th Cir. 1982), *rev'd on other grounds sub nom.* Aluminum Company of America v. Central Lincoln Peoples' Utility District, 464 U.S. 380 (1984); *see also* 903 F.2d at 588-89. Moreover, the Ninth Circuit granted Bonneville's May 14, 1990 motion to amend the opinion and accordingly issued its amended opinion, Aluminum Company of America v. Bonneville Power Administration, 903 F.2d 585 (9th Cir. 1990). As a result, the court changed language that arguably could have been interpreted to equate surplus

That is, nonfirm energy is energy that is available to Bonneville as the result of its having water available for power generation in excess of its historic lowest level used to establish its firm power capability. Surplus power and nonfirm power are therefore simply not the same. Firm surplus power means, then, firm power that exceeds the regional need for such power and therefore is surplus even though it may be energy in excess of minimum production, *i.e.*, at minimum water levels.

In addition, the Northwest Power Act addresses the sale of power, including firm power, by Bonneville without imposing any limits on customers to which Bonneville can market that power.[26] In this regard, we note that Bonneville has a contract with Southern California Edison Company for the sale of surplus firm power,[27] and that the contract expressly provides for the sale of surplus firm power pursuant to the SP-85 rate schedule.

Based on the above, we conclude that both firm and nonfirm power may be sold outside the Pacific Northwest region and that section 7(k) applies only to nonfirm sales.[28]

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energy to nonfirm energy. *Compare* 903 F.2d at 587, 588, 595 *with* 891 F.2d at 750, 751, 757.

In this regard, we note that "Bonneville integrates hydroelectric energy production with other energy-producing resources. Bonneville describes the reservoir as an inventory of energy, in which the quantity of water depends not only on streamflows, but on the use of thermal resources, power purchases, and conservation." 903 F.2d at 588.

[26] 16 U.S.C. § 839f(d) (1988).

[27] U.S. Department of Energy—Bonneville Power Administration, 36 FERC ¶ 61,350 (1986).

[28] In Aluminum Company of America v. Bonneville Power Administration, 903 F.2d 585, 591-94 (9th Cir. 1990), the

Bonneville's Marketing Activities

The Commission held in its April 6, 1988 order that Bonneville could only sell nonfirm power outside the region. Accordingly, the petitioners assert that the Commission sought to control how Bonneville markets its power, because under the Commission's April 6, 1988 order Bonneville could not sell firm power to customers outside the Pacific Northwest region. The petitioners argue that the Commission has no authority over Bonneville's marketing activities. Bonneville adds that its power marketing authority is exclusive and Bonneville's determination of the products it markets and the manner in which it markets them is a given for purposes of the Commission's rate review.

As discussed above, we are reversing our earlier finding that Bonneville can only sell nonfirm power outside the region. This reversal effectively moots the petitioners' assertion that the Commission somehow sought to control Bonneville's marketing practices. Moreover, Bonneville's authority to market power is an exclusive grant of authority from Congress under four statutes: the Bonneville Project Act, 16 U.S.C. §§ 832-832*l*, the Regional Project Act, 16 U.S.C. §§ 837-837h, the Federal Columbia River Transmission System Act, 16 U.S.C. §§ 838-838k, and the Northwest Power Act, 16 U.S.C. §§ 839-839h. After

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Ninth Circuit held that the Commission may not hold an evidentiary hearing under section 7(k) to supplement a record we think is inadequate. The court did not completely foreclose the possibility that an evidentiary hearing could be held under other circumstances. *Id.* at 594. However, since the Commission agrees with the Ninth Circuit's decision, we do not anticipate evidentiary hearings in future section 7(k) proceedings.

a power product has been identified, Bonneville establishes a rate for the sale of the product. Only then does the Commission exercise its authority to confirm and approve, or disapprove, that rate. As Bonneville states, its authorization to market surplus power is separate from its authority to set rates. The Commission's role is limited to the latter, to the review of rates established by Bonneville.

Recovery of Firm Power Costs

The April 6, 1988 order does not address Bonneville's recovery of its firm power costs to repay the Federal treasury. Bonneville, however, argues that if the Commission plans to examine the cost basis for surplus firm power in the ordered evidentiary hearing, Bonneville is entitled to recover its firm power cost to repay the Federal treasury. Section 7(g) of the Northwest Power Act provides that Bonneville shall equitably allocate to power rates, in accordance with generally accepted ratemaking principles, all costs and benefits not otherwise allocated.[29] That is, section 7(g) provides for the recovery of costs associated with the sale of surplus or excess power. As discussed earlier, we now find that surplus power can be considered firm power. Accordingly, we find that Bonneville is entitled to recover its firm power costs through the firm power rates at issue here.[30]

Other Issues

Bonneville claims that the April 6, 1988 order attempts to review Bonneville's transmission policies,

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[29] 16 U.S.C. § 839e(g) (1988).

[30] *Cf.* 909 F.2d at 342-43 & n.5.

and that the order therefore exceeds the scope of the Commission's regulatory authority. Since we have granted rehearing, and have found that section 7(a) of the Northwest Power Act is applicable in the instant proceeding, as opposed to section 7(k), this issue is now moot.

The California Utilities request rehearing for the purpose of clarifying the effect of the April 6, 1988 order on Bonneville's SP-85 rate schedule at issue in Docket No. EF85-2011.[31] The California Utilities ask the Commission to rule that sales made under Bonneville's SP-85 rate schedule (short-term surplus firm power) must be sold under Bonneville's NF-85 rate schedule (nonfirm energy rate). We will address Bonneville's SP-85 rate schedule in a subsequent order in Docket No. EF85-2011.

The Commission orders:

(A) The M-S-R's, the Oregon Commission's and the Washington Water Power's untimely motions to intervene are hereby granted, subject to the Commission's Rules of Practice and Procedure.

(B) The petitioner's requests for rehearing are hereby granted, as discussed in the body of this order.

(C) The California Utilities' request for clarification is hereby deferred, and, as discussed in the body of this order, will be addressed in Docket No. EF85-2011.

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[31] In the April 6, 1988 order, the Commission, based upon its finding that all nonregional sales were nonfirm (a finding we reverse herein), stated that the presiding judge in Docket No. EF85-2011 need not address whether the SP-85 rate schedule was effectively interruptible so that it should be considered nonfirm. 43 FERC at 61,088-89 n.20.

By the Commission.

[SEAL]

/s/ Lois D. Cashell
Lois D. Cashell
Secretary

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No. 90-505

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1990

CALIFORNIA PUBLIC UTILITIES COMMISSION,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION
and
BONNEVILLE POWER ADMINISTRATION,
Respondents.

REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

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INTRODUCTION

Respondents' Brief in Opposition conclusively demonstrates how in the proceeding below Petitioner and the other parties from California were denied a meaningful opportunity to contest Schedules NF-1 and NF-2 established by the Bonneville Power Administration ("BPA") for the sale of nonfirm energy. Like the Federal Energy Regulatory Commission ("FERC") and the Court of Appeals earlier, Respondents failed even to address various points of fact and law critical to the review of those rates under Section 7(k) the Pacific Northwest Electric Power Planning and Conservation Act ("Pacific Northwest Act"), 16 U.S.C. § 839e(k). In particular, Respondents overlook (1) that the plain language of Section 7(k) authorizes the FERC to hold an evidentiary hearing; (2) that the purpose of Congress in enacting Section 7(k) was to protect California against the BPA's bias in favor of the Pacific Northwest; (3) that the BPA neither plans nor operates its system for the purpose of providing reliable

service to California; (4) that the FERC had in earlier decisions consistently rejected the assignment of fully-allocated costs to purchasers of nonfirm energy; and (5) that in the proceeding below the FERC departed from this precedent without explanation. Accordingly, in order to achieve a fair resolution of the issues underlying ratemaking by the BPA, review by this Court is imperative.

ARGUMENT

I.

THE COURT BELOW COMMITTED A CLEAR ERROR OF JUDGMENT IN CONCLUDING THAT, UNDER SECTION 7(k) OF THE PACIFIC NORTHWEST ACT, THE FERC LACKS AUTHORITY TO HOLD AN EVIDENTIARY HEARING WHEN REVIEWING RATES THE BPA CHARGES CALIFORNIA FOR NONFIRM ENERGY.

Respondents contend that the court below reasonably concluded that the FERC lacks authority under Section 7(k) of the Pacific Northwest Act to hold an evidentiary hearing when reviewing rates charged California by the BPA for nonfirm energy Opp. at 8. They fail to address, however, that any inquiry into the scope of the FERC's authority should have ended with the court's recognition that, in clear and unambiguous terms, Section 7(k) provides for just such a hearing:

> [A] literal reading of the last sentence of section 7(k) appears to allow an evidentiary hearing before the FERC, because the additional hearing section 7(k) provides for under the Federal Power Act is a de novo proceeding in which the FERC takes evidence.

App. at A-21; *see* Pet. at 9. As this Court has explained, "If the statute is clear and unambiguous, 'that is the end of the matter, for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.' " *Board of Governors, FRS v. Dimension Financial Corp.*, 474 U.S. 361, 386 (1986), *quoting Chevron U.S.A., Inc. v. Natural Resources Council, Inc.*, 467 U.S. 837, 842-842 (1984); *see also K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 292 (1988).

Respondents cannot escape this result by arguing that an evidentiary hearing before the FERC is precluded by the additional requirement of Section 7(k) that the FERC's review be "based on" the record developed by the BPA. Opp. at 10; *see also* App. at A-18 to A-19. Even if it found Section 7(k) to be ambiguous, the court below could not reject the FERC's interpretation unless it were "arbitrary, capricious, or manifestly contrary to the statute." *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, supra, 467 U.S. at 844. Since it found that "the question is close and very difficult," however, it was not free to substitute its own construction. *See* App. at A-28. Moreover, by requiring the FERC to base its review on the BPA's record, Section 7(k) simply specifies the foundation for, not a limitation on, further analysis. If that record is inadequate, an additional evidentiary hearing before the FERC is an entirely logical way to resolve any matter in dispute. *See* 18 C.F.R. § 385.505.

Nonetheless, Respondents question how customers in California would be denied an impartial hearing if the FERC were not able to take additional evidence. Opp. at 11, n.8. They overlook, however, that the purpose of Congress in enacting Section 7(k) was to protect those customers against the BPA's well-recognized bias in favor of the Pacific Northwest. *Central Lincoln Peoples' Utility District v. Johnson*, 735 F.2d 1101, 1113 (9th Cir. 1984). Toward this end, Congress expressly directed the FERC to review the rates the BPA charges them "in accordance with the procedures governing rates filed by public utilities pursuant to the Federal Power Act." *See Southern California Edison Co., v. FERC*, 770 F.2d 779, 784 (9th Cir. 1985). As explained in the legislative history of Section 7(k), but ignored by Respondents, "FERC's review will be based on the BPA record *and on any FERC proceeding*." H.R. Rep. No. 96-976, Part 1, 96th Cong., 2d Sess. at 70 (emphasis added); *see also* App. at A-23.

For similar reasons, Respondents' reliance on *United States v. City of Fulton*, 475 U.S. 657 (1986), is misplaced. *See* Opp. at 11. In that case, involving the Southwestern Power Administration, this Court noted in passing that, in reviewing rates established by federal Power Marketing Administrations ("PMAs") pursuant to Section 5 of the Flood Control Act of 1944, 16 U.S.C.

§ 825s, the practice of the FERC would be to remand the record for supplementation if necessary rather than conduct its own evidentiary hearing. 475 U.S. at 663. By contrast, with enactment of Section 7(k) of the Pacific Northwest Act, Congress has created an entirely separate process with respect to rates established by the BPA for the sale of nonfirm energy to California. *See Southern California Edison Co. v. FERC, supra,* 770 F.2d at 785-786.

Nor is any escape afforded Respondents by their contention that the FERC now agrees that it lacks authority to hold an evidentiary hearing, or even that this has been the BPA's position all along. Opp. at 9. In the first place, although this Court observed in *Aluminum Co. of America v. Central Lincoln Peoples' Utility District,* 467 U.S. 380, that the BPA's interpretation of the Pacific Northwest Act is to be given "great weight," an entirely different situation is presented in the case at hand. Here, the BPA is acting as a proprietary agency, whose rates charged for the sale of nonfirm energy outside the Pacific Northwest are subject to special review by the FERC. *See Central Lincoln Peoples' Utility District v. Johnson, supra,* 735 F.2d at 1113. Indeed, to allow the BPA freely to interpret the rules governing such review would be to nullify the protection Congress intended that California be provided.

Similarly undeserving of deference is the position announced by the FERC in a separate proceeding subsequent to the decision of the court below. As stated by this Court and acknowledged by Respondents (Opp. at p.10), "An agency interpretation of a relevant provision which conflicts with the agency's earlier interpretation is 'entitled to considerably less deference' than a consistently held agency view." *INS v. Cardoza-Fronseca,* 480 U.S. 421, 446, n.30 (1987), *quoting Watt v. Alaska,* 451 U.S. 259, 273 (1981). Moreover, the relevant inquiry here is not what is the new position of the FERC, but was the construction of Section 7(k) under review in the proceeding below impermissible? *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., supra,* 467 U.S. at 843. Because the court did not find it to be "manifestly contrary to the statute," the answer must be "no." *Id.* at 844.

II.

IN FAILING TO CONDUCT A CAREFUL AND SEARCHING REVIEW OF THE FERC'S DETERMINATION THAT CUSTOMERS IN CALIFORNIA SHOULD BE ASSIGNED THE BPA'S FULLY-ALLOCATED COSTS ON AN UNWEIGHTED, PROPORTIONAL BASIS IN THE RATES THEY PAY FOR NONFIRM ENERGY, THE COURT BELOW COMMITTED REVERSIBLE ERROR.

Respondents contend that the court below correctly determined that the FERC's approval of Schedules NF-1 and NF-2 was supported by substantial evidence. Opp. at 12. In making that determination, however, the court neglected to consider the whole record. Indeed, far from "tak[ing] into account whatever in the record fairly detract[ed] from its weight," the court merely adopted the FERC's findings and conclusions as its own. *See Universal Camera Corp. v. NLRB*, 340 U.S. 474, 488 (1951). Clearly, therefore, in failing to assess the evidence presented by both sides, the court "grossly misapplied" the standard of substantial evidence. *Id.* at 491; *see Mobil Oil Corp. v. FPC*, 417 U.S. 283, 310 (1974).

Respondents attempt to shield this failure from review by this Court as a "fact-bound determination." *See* Opp. at 13. The fact is, however, that neither the FERC nor the Ninth Circuit made a serious effort to reconcile conflicting evidence in the record. For this reason, review by this Court, although properly the province — at least in the first instance — of the Court of Appeals, is necessary for a fair resolution of the factual issues underlying ratemaking by the BPA. *See Universal Camera Corp. v. NLRB*, *supra*, 340 U.S. at 490-491.

Respondents go on to admit "the fact that BPA decides whether to invest in *additional* generating capacity on the basis of anticipated demand in the Pacific Northwest region," but contest the implication "that BPA operates *existing* facilities solely for the benefit of customers in that region." Opp. at 13 (emphasis in original). The point is, however, that at no time will the BPA operate any such facility to insure the availability of nonfirm energy for its customers in California. Indeed, it is prohibited

from jeopardizing service to the Pacific Northwest in this way both through contractual agreement and by operation of law. *See Central Lincoln Peoples' Utility District v. Johnson, supra,* 735 F.2d at 1112.

Despite this, Respondents further contend that, because they benefit from the BPA's entire system, customers in California should be allocated a proportional share of the BPA's full costs. Opp. at 13. Not only do those customers have no claim on the BPA's capacity, however, but they must stand in line behind all others in receiving service from the BPA. *See* 16 U.S.C. § 839f(c). Moreover, even when it is offered for sale to California, nonfirm energy is at all times subject to interruption if later needed in the Pacific Northwest. *Id.*

Respondents' contention here is further undermined by earlier decisions of the FERC limiting the allocation of fixed costs to purchasers of nonfirm energy. In Opinion No. 250, the FERC cited various of its "decisions under the Federal Power Act . . . as useful guides in addressing the question of how properly to develop costs for [the BPA's] nonfirm energy rate determination." App. at C-39. In each instance, however, the FERC allowed the selling utility to recover at most only some portion of its fully-allocated costs from the sale of nonfirm energy. *See* Pet. at 15. Typical of these cases is *Illinois Power Company,* in which the FERC stated:

> [F]or reasons of equity, we believe that some capacity cost contribution, *which is significantly less than fully allocated capacity costs,* by customers for this [nonfirm] service is supportable.

11 FERC ¶61,186, p. 61,384 (1980) (emphasis added). Moreover, in a prior case involving the BPA, the FERC recognized that, as a "lesser quality product," nonfirm energy should be sold to California at a lower price than the "higher quality firm power sold within the [Pacific Northwest]." *U.S. Department of Energy, Bonneville Power Administration,* 23 FERC 61,342 at pp. 61,739-61,740 (1983) (involving rates established before passage of the Pacific Northwest Act, but applying the statutes enumerated in Section 7(k)).

Nowhere in Opinion No. 250, however, does the FERC explain why it departed from these decisions in approving the assignment of the BPA's fully-allocated costs on an unweighted, proportional basis to customers in California in the rates they pay for nonfirm energy. *See* Pet. at 16. For that matter, neither the court below nor Respondents in their opposition even address this unexplained departure from precedent. For this reason alone, the decision below must be reversed. *Motor Vehicle Manufacturers Association v. State Farm Mutual Insurance Co.*, 463 U.S. 29 (1983). As explained by this Court:

> [A]n agency changing its course by rescinding a rule is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance.

Id. at 42; *see also Atchison, Topeka & Santa Fe Railway Co. v. Wichita Board of Trade*, 412 U.S. 800, 807-808 (1973).

On a related subject, Respondents contend that, "[a]ccording to petitioner, the costs associated with [the facilities of the Washington Public Power Supply System ('WPPSS')] should not have been included in BPA's rates because [they] did not produce energy during the period at issue here." Opp. at 14. In truth, however, Petitioner's position is that these costs, like any of the BPA's costs, should be recovered from those customers for whose benefit they were incurred. *See* Pet. at 18. Because their construction was undertaken solely to serve firm load in the Pacific Northwest, therefore, these facilities should not be paid for by California. Moreover, as overlooked by both the FERC and the court below, and now by Respondents, recovering the costs of the WPPSS from customers in the Pacific Northwest would fully insure the ability of the BPA to repay the federal investment in its system. *See* App. at D-4; App. at A-28; Opp. at 14. Under Section 7(a)(2)(B) of the Pacific Northwest Act, costs not allocated to customers in California became the responsibility of those in the Pacific Northwest. *See Central Lincoln Peoples' Utility District v. Johnson*, *supra*, 735 F.2d at 1115.

As a final matter, Respondents contend that both the FERC and the court below found that Schedules NF-1 and NF-2, as

required by Section 7(k), encouraged the widespread use of nonfirm energy at the lowest possible price consistent with sound business principles. Opp. at 13-14. This requirement is not a series of empty words, however, but instead imposes on the FERC a serious obligation to review how the BPA allocates its costs and designs its rates. *Central Lincoln Peoples' Utility District v. Johnson, supra*, 735 F.2d at 1113-1115. Indeed, to ignore the purpose for which resources are installed in Pacific Northwest — and thus who actually caused their costs to be incurred — would be to render meaningless the special protection which Congress intended California be provided through enactment of Section 7(k). *See id.* at 1113. Having neither considered these factors nor explained its departure from well-established precedent, the FERC committed "a clear error of judgment" which should have been reversed. *Motor Vehicle Manufacturers Association v. State Farm Mutual Insurance Co., supra*, 463 U.S. at 43; *Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 285 (1974). In turn, by adopting the FERC's findings and conclusions as its own without taking into account what in the record would have led logically to disapproval of Schedules NF-1 and NF-2, the court below failed to conduct a "searching and careful" inquiry, and its decision should now be reversed by this Court. *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 416 (1971).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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